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Fundamentals of Banking

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Preface

I am glad to present this book, especially designed to serve the needs of the students. The book has been written keeping in mind the general weakness in understanding the fundamental concepts of the topics. The book is self-explanatory and adopts the "Teach Yourself" style. It is based on question-answer pattern. The language of book is quite easy and understandable based on scientific approach.

Any further improvement in the contents of the book by making corrections, omission and inclusion is keen to be achieved based on suggestions from the readers for which the author shall be obliged.

I acknowledge special thanks to Mr. Rajeev Biyani, *Chairman* & Dr. Sanjay Biyani, *Director* (*Acad.*) Biyani Group of Colleges, who are the backbones and main concept provider and also have been constant source of motivation throughout this Endeavour. They played an active role in coordinating the various stages of this Endeavour and spearheaded the publishing work.

I look forward to receiving valuable suggestions from professors of various educational institutions, other faculty members and students for improvement of the quality of the book. The reader may feel free to send in their comments and suggestions to the under mentioned address.

Author

Syllabus

Unit I **Overview of Indian Banking Sector :** Structure of Indian Banking Sector, Source of Funds for a Bank, Various Deposits Products.

Unit II **Types of Bank Financing :** Fund based and non fund base, cash credit, bank Overdraft, term loan, demand loan, export/import financing, rural/farm lending etc. Bank Guarantee, Introduction to NPA and its management, classification of NPAs and recovery strategy.

Unit III **Central Banking Concept :** Function and Role of RBI-Money Creator, Credit Regulator, Supervision of Banking Sector, Reforms in Indian Banking - Narsimhan Committee I & II.

Unit IV **Fundamentals of Investment Banking :** Fund based and Fee based services, Innovation in banking : E-Banking.

Unit V **Introduction of NBFCs :** Role and Classification.

Unit 1
Overview of Indian Banking Sector

Multiple Choice Question

1. Which of the following statements is true?
   a) The licence to open branches of bank is granted by Board of Directors of that Bank
   b) There is no need of licenses to open branch of a bank
   c) A licence to open a branch is issued by the Central Government
   d) A licence to open a branch is issued by the Reserve Bank of India under the provisions of Banking Regulation Act, 1949

2. Which of the following is not a function of a commercial bank?
   a) Registration of charges and mortgages
   b) Transactions services
   c) Asset transaction
   d) Real-time Gross Settlement

3. The interest in savings bank accounts of a bank is calculated on?
   a) Minimum amount of balance that is maintained in the account in between 10th and the last day of month
   b) Maximum amount of balance that is maintained in the account in between 10th and the last of month
   c) Minimum amount of balance that is maintained in the account in between 1st and the last day of month
   d) Maximum amount of balance that is maintained in the account in between 1st and the last of month

4. Which of the following is not the function of commercial banks?
   a) Providing transaction services
   b) Intermediation in financial services
   c) Providing transformation services
   d) Regulating the issue of bank notes.

5. Saving Bank Account can be opened in the name of?
   a) State text book printing corporations
   b) District level housing cooperative societies
   c) Communist Party of India
   d) Aravind Samuel, Anurag Deepak and Amarish Sugandhi Jointly

6. The interest on recurring deposit is paid on the basis of?
   a) Simple interest calculated monthly basis
   b) Simple interest on monthly products basis
   c) Quarterly compounding
   d) Interest calculated on daily products basis

7. When the customer withdraws cash from ATM, the banker and customer relationship is?
   a) Debtor and Creditor
   b) Creditor and Debtor
   c) Lessor and Lessee
   d) Agent and principal

8. Which of the following is a public sector Bank?
   a) IDBI
   b) ICICI
   c) AXIS
   d) HDFC

9. Trade control in India is regulated by?
   a) RBI
   b) SEBI
   c) EXIM Bank
   d) DGFT

10. Which of the following is not directly involved in rural lending?
    a) Cooperatives
    b) RRBs
    c) Commercial banks
    d) SIDBI

Answers1) d 2) a 3) a 4) d5) d 6) c 7) a 8) a 9) d 10)d

Q.1 Write an overview or Indian banking sector?

Ans A bank is a financial institution and a financial intermediary that accepts deposits and channels those deposits into lending activities, either directly or through capital markets. A bank connects customers that have capital deficits to customers with capital surpluses.

Banking in India originated in the last decades of the 18th century. The first banks were The General Bank of India, which started in 1786, and Bank of Hindustan, which started in 1790; both are now defunct. The oldest bank in existence in India is the State Bank of India, which originated in the Bank of Calcutta in June 1806, which almost immediately became the Bank of Bengal. This was one of the three presidency banks, the other two being the Bank of Bombay and the Bank of Madras, all three of which were established under charters from the British East India Company. For many years the Presidency banks acted as quasi-central banks, as did their successors. The three banks merged in 1921 to form the Imperial Bank of India, which, upon India's independence, became the State Bank of India in 1955.

Q.2 Describe the structure of Indian banking sector?

Ans The initial banks in India were primarily traders' banks engaged only in financing activities. The industry in recent times has recognized the importance of private and foreign players in a competitive scenario and has moved towards greater liberalization.

Phases of evolution of the banking industry

Phase's	Major change
1-pre nationalization	Birth of joint stock company. Introduction of deposit banking and bank branches. presidency banks and other joint stock banks formed setting the foundation of modern banking system
2-Era of nationalization and consolidation	State bank of India formed out of imperial bank. Directed credit programs on the rise. Introduction of social banking
3-Introduction of Indian financial &banking sector reforms and partial liberalization	Major changes in prudential regulations Statutory preemption of resources eased more private sector players came in strengthens the system as a whole.

4-Period of increased liberalization	FDI ceiling for the banking sector increased to 74%from 49%. Roadmap for inclusion of foreign banks declared. More liberal branch licensing policy followed

Structure of Indian Banking As per Section 5(b) of the Banking Regulation Act 1949: "Banking" means the accepting, for the purpose of lending or investment, of deposits of money from the public, repayable on demand or otherwise, and withdrawal by cheque, draft, order or otherwise." All banks which are included in the Second Schedule to the Reserve Bank of India Act, 1934 are scheduled banks. These banks comprise Scheduled Commercial Banks and Scheduled Cooperative Banks. Scheduled Commercial Banks in India are categorized into five different groups according to their ownership and / or nature of operation.

These bank groups are:
(i) State Bank of India and its Associates,
(ii) Nationalized Banks,
(iii) Regional Rural Banks,
(iv) Foreign Banks and
(v) Other Indian Scheduled Commercial Banks (in the private sector). Besides the Nationalized banks (majority equity holding is with the Government), the State Bank of India (SBI) (majority equity holding being with the Reserve Bank of India) and the associate banks of SBI (majority holding being with State Bank of India), the commercial banks comprise foreign and Indian private banks.

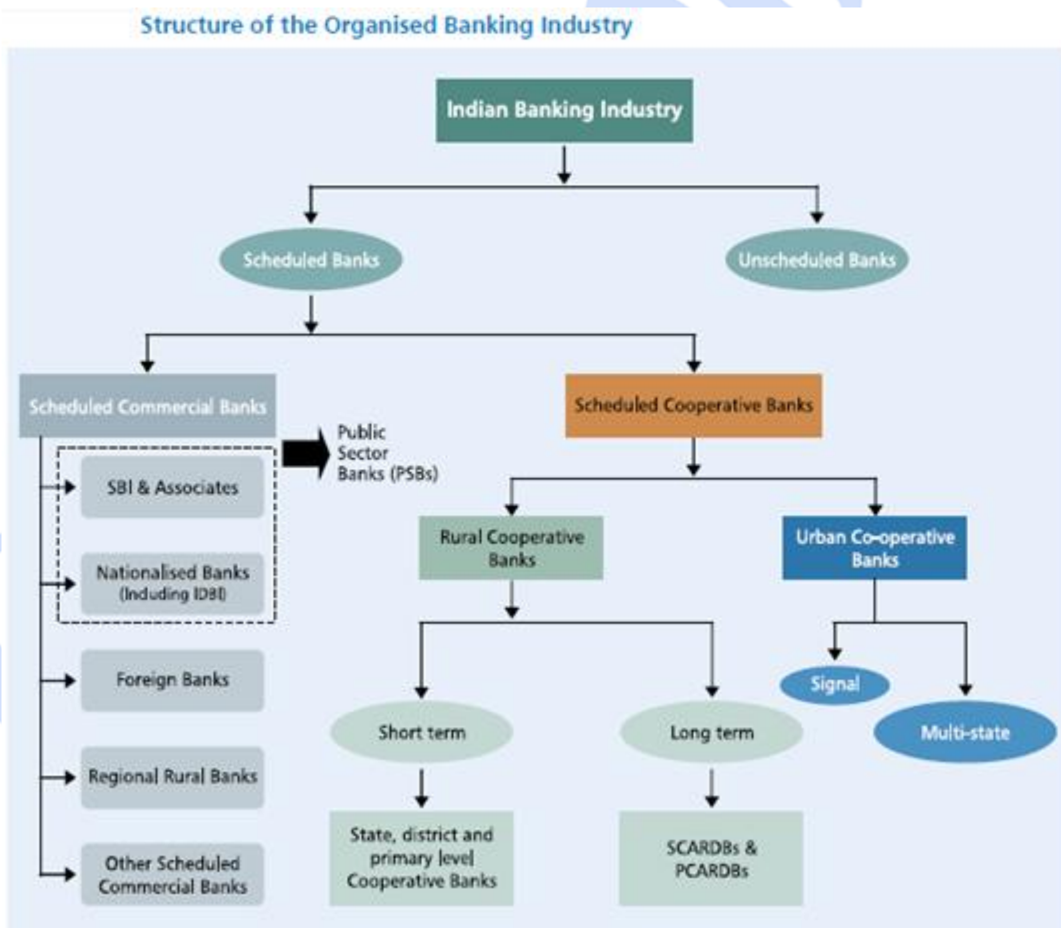
While the State bank of India and its associates, nationalized banks and Regional Rural Banks are constituted under respective enactments of the Parliament, the private sector banks are banking companies as defined in the Banking Regulation Act. These banks, along with regional rural banks, constitute the public sector (state owned) banking system in India. The Public Sector Banks in India are back bone of the Indian financial system. The cooperative credit institutions are broadly classified into urban credit cooperatives and rural credit cooperatives.

Scheduled Co-operative Banks consist of Scheduled State Co-operative Banks and Scheduled Urban Co-operative Banks. Regional Rural Banks (RRB's) are state sponsored, regionally based and rural oriented commercial banks.

Scheduled Banks

A scheduled bank is a bank that is listed under the second schedule of the RBI Act, 1934. In order to be included under this schedule of the RBI Act, banks have to fulfill certain conditions such as having a paid up capital and reserves of at least 0.5 million and satisfying the Reserve Bank that its affairs are not being conducted in a manner prejudicial to the interests of its depositors.

Scheduled banks are further classified into commercial and cooperative banks. The basic difference between scheduled commercial banks and scheduled cooperative banks is in their holding pattern. Scheduled cooperative banks are cooperative credit institutions that are registered under the Cooperative Societies Act. These banks work according to the cooperative principles of mutual assistance.



Regional Rural Banks (RRBs) were set up in September 1975 in order to develop the rural economy by providing banking services in such areas by combining the cooperative specialty of local orientation and the sound resource base which is the characteristic of commercial banks.

Scheduled Cooperative Banks:
Scheduled cooperative banks in India can be broadly classified into urban credit cooperative institutions and rural cooperative credit institutions. Rural cooperative banks undertake long term as well as short term lending. Credit cooperatives in most states have a three tier structure (primary, district and state level).

Non-Scheduled Banks:
Non-scheduled banks also function in the Indian banking space, in the form of Local Area Banks (LAB). As at end-March 2009 there were only 4 Local area banks operating in India. Local area banks are banks that are set up under the scheme announced by the government of India in 1996, for the establishment of new private banks of a local nature; with jurisdiction over a maximum of three contiguous districts. Local area banks aid in the mobilization of funds of rural and semi urban districts. Six Local area banks were originally licensed, but the license of one of them was cancelled due to irregularities in operations, and the other was amalgamated with Bank of Baroda in 2004 due to its weak financial position.

Q-3 What are the sources of funds for banks?

Ans A bank is a business firm. Its main aim is to earn profit. In order to achieve this objective it provides services to the customers. It offers a variety of interest bearing obligations to the public. These obligations are the sources of funds for the bank and are shown on the liability side of the balance sheet of a commercial bank. The main sources which supply funds to a bank are as follows:
A Bank's Own Funds.
B Borrowed Funds.

1. Bank's own funds. Bank's own funds are mainly of three types; (a) Paid up capital, (b) Reserve fund and (C) Portion of undistributed profit.
(A) Banks Own Funds.
Bank's own paid up capital. The amount with which a banking company is registered is called nominal or authorized capital. It is the maximum amount of capital which is mentioned in the capital clause of the memorandum of association of the company. Capital is further divided into (i) paid up capital and (ii) subscribed capital. The banks in Pakistan raise authorized capital by issuing ordinary shares ofRs. 10 each which are fully paid up.

2. Reserve fund. Reserve is another source of fund which is maintained by all commercial banks. At the time of declaring dividend, a certain portion of the profit is transferred to the reserve fund. This reserve belongs to the .shareholders

and at the time of liquidation, the Shareholders are entitled to these reserves along with the capital.
The main purpose of setting aside part of profit is to meet unforeseen expenses of the bank. The Banking Companies Ordinance has made it obligatory (binding) for every banking company incorporated in Pakistan to create a reserve fund.

3. Profit. Profit is another source to a bank for the purpose of business. Profits signify the credit balance of the profit and loss account which has not been distributed. The accumulated profits over the years increase the working capital of the bank and strengthen its financial position.
(B) Borrowed Funds.
The borrowed capital is a major and an important source of fund for any banking business. It mainly comes from deposits which are accepted on varying terms in different accounts.
Bank's borrowing is mostly in the form of deposits. Bank collects three kinds of deposits from its customers (1) current or demand deposits (2) saving deposits and (3) fixed or time deposits. The larger the deposits of bank, the larger will be its (use) fund for employment and so higher are its profit.
1. **Borrowing from central bank.-** The commercial banks in times of emergency borrow loans from the central bank of the country. The central bank extends help as and when financial help is required by the commercial banks.
2. **Other sources**- Bank also raise funds by issuing bonds, debentures, cash certificates etc. etc. Though it is not common but is a dependable source of borrowing.
3. **Deposits**- Public deposits are a powerful source of funds to a bank. There are' three types of bank deposits (i) current deposits (ii) saving deposits and (iii) time deposits. Due to the spread of literacy, banking habits and growth in the volume of business operations, there is a marked increase in deposit money with banks.

Q.4 Write an Introduction to deposit products?

Ans Banks or depository institutions are important in ensuring that the financial system and the economy run smoothly and efficiently because they play a major role in channeling funds to borrowers with productive investment opportunities.
Banks are profit seeking business firms dealing in money, or rather dealing in claims to money, or rather dealing in claims to money.
Main characteristics of bank which is not included in traditional definition of banks-
a) Banks accept deposit of the public.
b) The deposited sum is advance in form of loan or investment.
c) The payment is made either, through credit instruments or in some other form.
d) Bank performs the functions of agency services and general utility services.
e) Banks must have a particular place to perform their business.
f) Banks must the World Bank, banker and banking as part of their name.

Commercial bank-a commercial bank is an institution which accepts deposits from the public and also one which accepts deposits from public and also one which makes loans and advances to the public. It must be noted that a commercial bank has the power to create credit and thereby contribute to money supply in an economy.
What are the various deposit products in banks?
Traditionally banks in India have four types of deposit accounts, namely Current Accounts, Saving Banking Accounts, Recurring Deposits and, Fixed Deposits.
However, in recent years, due to ever increasing competition, some banks have introduced new products, which combine the features of above two or more types of deposit accounts. These are known by different names in different banks, e.g. 2-in-1 deposits, Smart Deposits, Power Saving Deposits, and Automatic Sweep Deposits etc. However, these have not been very popular among the public.

1 Current Account-
Current Accounts are basically meant for businessmen and are never used for the purpose of investment or savings. These deposits are the most liquid deposits and there are no limits for number of transactions or the amount of transactions in a day. Most of the current accounts are opened in the names of firm / company accounts. Cheque book facility is provided and the account holder can deposit all types of the cheques and drafts in their name or endorsed in their favour by third parties. No interest is paid by banks on these accounts. On the other hand, a bank charges certain service charges, on such accounts.

Features of Current Accounts:
(a) The main objective of Current Account holders in opening this account is to enable them (mostly businessmen) to conduct their business transactions smoothly.
(b) There are no restrictions on the number of times deposit in cash / cheque can be made or the amount of such deposits;
(c) Usually banks do not have any interest on such current accounts. However, in recent times some banks have introduced special current accounts where interest (as per banks' own guidelines) is paid
(d) The current accounts do not have any fixed maturity as these are on continuous basis accounts

2 Savings Bank Account -
These deposits accounts are one of the most popular deposits for individual accounts. These accounts not only provide cheque facility but also have lot of flexibility for deposits and withdrawal of funds from the account. Most of the banks have rules for the maximum number of withdrawals in a period and the maximum amount of withdrawal, but hardly any bank enforces these.

However, banks have every right to enforce such restrictions if it is felt that the account is being misused as a current account. Till 24/10/2011, the interest on Saving Bank Accounts was regulated by RBI and it was fixed at 4.00% on daily balance basis. Under directions of RBI, now banks are also required to open no frill accounts (this term is used for accounts which do not have any minimum balance requirements). Although Public Sector Banks still pay only 4% rate of interest, some private banks like Kotak Bank and Yes Bank pay between 6% and 7% on such deposits.

3 Recurring Deposit Accounts -These are popularly known as RD accounts and are special kind of Term Deposits and are suitable for people who do not have lump sum amount of savings, but are ready to save a small amount every month. Normally, such deposits earn interest on the amount already deposited (through monthly installments) at the same rates as are applicable for Fixed Deposits / Term Deposits.

Recurring Deposit accounts are normally allowed for maturities ranging from 6 months to 120 months. A Pass book is usually issued where in the person can get the entries for all the deposits made by him / her and the interest earned. Banks also indicate the maturity value of the RD assuming that the monthly installments will be paid regularly on due dates These accounts can be opened in single or joint names. Nomination facility is also available.

The RD interest rates paid by banks in India are usually the same as payable on Fixed Deposits, except when specific rates on FDs are paid for particular number of days e.g. 500 days, 555 days, 1111 days etc i.e. these are not ending in a quarter.

4 Fixed Deposit Accounts /Term Deposits. These are also popularly known as FD accounts. However, in some other countries these are known as "Term Deposits" or even called "Bond". The term "fixed" in Fixed Deposits (FD) denotes the period of maturity or tenor. Therefore, the depositors are supposed to continue such Fixed Deposits for the length of time for which the depositor decides to keep the money with the bank. However, in case of need, the depositor can ask for closing (or breaking) the fixed deposit prematurely by paying a penalty (usually of 1%, but some banks either charge less or no penalty).

The rate of interest for Fixed Deposits differs from bank to bank (unlike earlier when the same were regulated by RBI and all banks used to have the same interest rate structure. The present trends indicate that private sector and foreign banks offer higher rate of interest.

Unit 2

Types of Bank Financing

Multiple Choice Questions

1. The credit policy of a bank does not consist of?
   a) Lending policies
   b) Quality control
   c) Loan product mix
   d) advertising of loan products

2. The important feature of an anticipatory letter of credit is that?
   a) The letter of credit can be used as back- to- back letters of credit
   b) The beneficiary under the letter of credit may receive payment even at the pre-shipment stage
   c) The beneficiary under the letter of credit may receive payment even at the post-shipment stage
   d) The cash advance is not permitted against such letter of credits

3. The Shipping guarantee is a?
   a) Type of a letter of credit
   b) Guarantee issued by the ship captain to the purchaser
   c) Guarantee issued to the borrower towards the loan granted by the shipping company
   d) Deferred payment guarantee issued by a banker at the request of the consignee when the documents are not received and goods are received, for facilitating the delivery of goods.

4. Which of the following statements is true?
   a) The charge card is a credit instrument
   b) Under this facility the cardholders need to pay amount within ten installments
   c) Cardholder has to pay the 100% of the purchase amount within 30 days of purchase
   d) The charge card shall have revolving credit

5. Which of the following is not augmented feature of a credit card?
   a) Personal accident insurance

b) Cash withdrawals
c) Add-on facility
d) Issue of deferred guarantee

6. The credit policy of a bank does not deal with?
a) Credit risk management
b) Documentation standards
c) Review and renewal of advances
d) Outstanding balances in deposit accounts

7. Issuing credit cards is a component of?
a) Corporate banking
b) rural banking
c) Retail banking
d) Micro finance

8. Which of the following is not a transfer of funds by using the electronic media?
a) Mail transfer of funds
b) Telegraphic transfer of funds
c) Electronic credit transfers
d) Electronic clearing transfers

9 Which of the following is not an augmenting feature of credit cards?
a) Personal accident insurance
b) Cash withdrawal facility
c) Add-On facility
d) Automatic recovery of interest on term loans

10 Which of the following is a disadvantage of going public issue?
a) Provides liquidity to existing shares
b) Commands better pricing than placement with few investors
c) Increased regulatory norms
d) Enables valuation of the company

11 Which of the following is not a reason for regulating the banking operations?
a) Banks hold a major portion of the public savings
b) Banks intermediate between the savings and investments
c) Banks hold a large part of the money supply
d) Banks earn profit from non-fund services

12 Which of the following statements is true?
a) Resave Bank of India empowers the banks to open branches according to

their will and pleasure
b) Reserve Bank of India is a central bank which monitors only lending activities pertaining to export credit
c) Banks have authority to establish the ATMs at their convenience
d) rural banks of commercial banks do not have freedom to issue credit cards

13. Which of the following is not one of the RBI directives on clean note policy?
a) Currency note packets are not to be stapled and secured with paper bands
b) Soiled notes are to be stapled before they are remitted to Currency Chest.
c) Water mark window of bank notes shall not contain any writings
d) Currency notes are to be sorted in to Issuable and non-issuable notes.

14. The Reverse Repo has the following characteristic?
a) Borrowing by RBI from banks
b) borrowing with government security as collateral
c) Short term borrowing
d) all of these

15. Which of the following statement is CORRECT?
a) Consortium advances to be treated as NPA on the basis of recovery by individual banks
b) If one facility of a borrower is treated as NPA other facilities to him also to be treated as NPA even if there are no irregularities in that account.
c) Consortium must be formed if the total exposure of fund based limit exceeds Rs 100 crore.
d) Both (a) and (b)

16. Funded Services under corporate banking does not include?
a) Working Capital Finance
b) Bill Discounting
c) Export Credit
d) Letters of Credit

Answer-1) d 2) b 3) d 4) c 5) d 6) d 7) c 8) a 9) d 10) c 11) d 12) c 13) b 14) d 15) a 16) d

Q.1 What is Fund Based Bank Financing?

Ans Fund based functions of a bank are those in which banks make deployment of their funds either by granting advances or by making investments for meeting gaps in funds requirements of their customers/ borrowers.

In case of fund based lending bank commits the physical outflow of funds. As such, the funds position of the lending bank gets affected. Fund-based functions of a bank may be classified into two parts:

•Granting of Loans and Advances

•Making Investments in shares/ debentures/ bonds

The fund based lending can be made by the banks in the following forms-

(a) loan.

(b) Overdraft.

(c) Cash credit.

(d) Bills purchased/discounted.

(e) Working capital term loans.

(F) Packing credit.

Q.2 What is non fund based bank financing?

Ans In case of non fund based lending, the lending bank does not commit any physical outflow of funds. As such, the funds position of the lending bank remains intact. These may be available from financial institutions under many different guises or marketing packages, or Loans that do not have any underlying securities and are extended purely based on the creditworthiness of the organization. This lending is also called Non-assets based lending

The non fund based lending can be made by the banks in two forms.

a) Bank guarantee.

b) Letter of credit.

BANK Guarantees -

The conditions relating to obligant being a customer of the bank enjoying credit facilities as discussed in case of letters of credit are equally applicable for guarantees also. In fact, guarantee facilities also cannot be sanctioned in isolation.

Financial guarantees will be issued by the banks only if they are satisfied that the customer will be in a position to reimburse the bank in case the guarantee is invoked and the bank is required to make the payment in terms of guarantee.

Performance guarantee will be issued by the banks only on behalf of those customers with whom the bank has sufficient experience and is satisfied that the customer has the necessary experience and means to perform the obligations under the contract and is not likely to commit any default. As a rule, banks will guarantee shorter maturities and leave longer maturities to be guaranteed by other institutions. Accordingly, no bank guarantee will normally have a maturity of more than 10 years.

Banks should not normally issue guarantees on behalf of those customers who enjoy credit facilities with other banks.

<u>Co acceptance of Bills</u>

Letter of credit is, a method of settlement of payment of a trade transaction and is widely used to finance purchase of machinery and raw material etc. It contains a written undertaking given by the bank on behalf of the purchaser to the seller to make payment of a stated amount on presentation of stipulated documents and fulfilment of all the terms and conditions incorporated therein. All letters of credit in India relating to the foreign trade i.e., export and import letters of credit are subject to provisions of 'Uniform Customs & Practice for Documentary Credits' (UCPDC). These provisions neither have the status of law or automatic application but parties to a letter of credit bind themselves to these provisions by specifically agreeing to do so. These provisions have almost universal application and help to arrive at unambiguous interpretation of various terms used in letters of credit and also set the obligations, responsibilities and rights of various parties to a letter of credit.

Q3 What is Cash credit?

Ans This account is the primary method in which Banks lend money against the security of commodities and debt. It runs like a current account except that the money that can be withdrawn from this account is not restricted to the amount deposited in the account. Instead, the account holder is permitted to withdraw a certain sum called "limit" or "credit facility" in excess of the amount deposited in account.

Cash Credits are, in theory, payable on demand. These are, therefore, counter part of demand deposits of the Bank. This means that the payments to repay the loan may start out low, but if the interest rate increases, then so do the monthly payments. In addition, some cash credit accounts have prepayment penalties. This means that if the cash credit account is paid off before the term of the loan is complete, then the borrower must pay a percentage of the loan amount as a penalty fee. As with many types of financial assistance, cash credit is extended under terms that are set and controlled by the institution that provides the loan.

EXAMPLE-A person is having a business. To carry on this business he needs to purchase raw material, and sell the goods. For this he needs working capital to run his daily business. Hence total amount of money put in or invested in running the business is only to the extent of money invested in stock in hand(for which money is paid) and debtors(where again money is invested) less the amount of stock received on credit from creditors(here the amount is not invested for purchase of stock).

This working capital that is required to run the business can be either funded by the businessman himself or if he does not have the money he can take a loan i.e. Cash credit.

In Cash Credit facility an amount of loan is given to the borrower/businessman for his working capital needs. The entire amount of working capital required is not funded by the bank, some small amount will have to be funded by the businessman and the balance amount will be funded by a bank as a loan. This is as per RBI rules.

The amount so worked out is given as loan and is called as "limit" this is because under this kind of loan the borrower may not take up the entire amount of loan as working capital requirement every day is not the same, i.e. on one day the amount of working capital required may for eg. May be Rs. 96,000 and on another day it may be Rs. 92,000 as some debtor might have paid up some amount. Hence the businessman will require Rs.96,000 on one day and he will require Rs. 92,000 on the other day only. He on a particular day may require Rs. 1,07,300 but the loan amount that he can get is any amount which is not more than the "limit" of the loan given. If in the above eg. Limit is say Rs. 1 lakh then when he requires Rs. 1.07300 he will get loan upto Rs. 1 lakh only. The reason why he should borrow different amounts on different days as per the amount required by him on that day is that the interest calculated is on daily basis on the amount borrowed by him on different days. i.e. if amount required by him say on a particular day is say Rs.92,000 but he takes entire amount Rs. 1,00,000 he will have to pay interest on entire amount of Rs. 1 lakh. However if he would have only taken say Rs. 92,000 which he required he would have to pay interest on Rs. 92,000 only and not on Rs 1,00,000.

Q.4 What is Overdraft?

Ans An overdraft occurs when money is withdrawn from a bank account and the available balance goes below zero.

An overdraft facility is a formal arrangement with a bank that allows an account holder to draw on funds in excess of the amount on deposit. This type of financing is most commonly used by businesses as a way of making their working capital more flexible, although it can also be available to individuals. Banks that offer this service typically have a number of expectations from customers who use it, and it is important for customers to be aware of these expectations before entering an agreement.

The idea behind overdraft facility agreements is that sometimes one needs a bit more money than is available on deposit to deal with various expenses. For example, a business that is always slow in March and April might need help to make payroll and keep current with all accounts and creditors. Another business might need to make a big one-time expense that exceeds the funds on deposit.

With an overdraft agreement, the company can repay the funds at its convenience. The bank may charge an overdraft fee for accessing the money, however, and the interest rate can be higher than that for other types of loans. The bank also has the right to demand repayment in full. Balancing an overdraft facility wisely can free up capital and make people more stable financially, but unwise use can lead people into a spiral of debt that may be difficult to escape.

Overdraft limit-

An overdraft limit is the highest amount of credit or money a person has available for overdrafts on a particular account. For example, a person can usually withdraw or make payments up to the amount of money he has available in his account. If a withdrawal or payment causes him to exceed this amount, this is referred to as an overdraft. When a bank allows a withdrawal or completes a payment for which the person does not have money available, it is extending credit to the account holder and usually places limits on the amount of credit it will extend. An individual may also have a separate account or a credit card to use for overdrafts, in which case he could designate his own overdraft limit.

An overdraft limit may be placed on an account by a financial institution or it may be self-imposed. For example, some banks automatically pay overdrafts for account holders in good standing and place limits on how much, and when, they will pay them. In other cases, however, a person may open an overdraft account with a bank for this purpose. Overdrafts are then taken from this account up to the limit on the account.

Q.5 What are term loans?

Ans A loan is the purchase of the present use of money with the promise to repay the amount in the future according to a pre-arranged schedule and at a specified rate of interest. A monetary loan that has to be repaid in regular payments over a set period of time is referred to as a term loan.

Bank term loans are very a common kind of lending. An unfixed interest rate is usually involved in a term loan that will add additional balance to be repaid. Term loans are generally provided as working capital for acquiring income producing assets (machinery, equipment, and inventory) that generate the cash flows for repayment of the loan. The repayment of the loans and facilities is normally fixed on case to case basis depending on projected cash flow of the borrower. Term loans are a good way of quickly increasing capital in order to raise a business' supply capabilities or range. One thing to consider when getting a term loan is whether the interest rate is fixed or floating.

Interest rate of term loan-

PUBLIC SECTOR BANKS

State Bank of India	7.50%
Federal Bank	7.75%
State Bank of Mysore	7.75%
Corporation Bank	7.75%
Bank of India	8.00%
Punjab National Bank	8.00%
Central Bank of India	8.00%
Indian Overseas Bank	8.25%
PRIVATE SECTOR BANKS	
HDFC Bank	7.25%
ICICI Bank	7.50%
Dhanlaxmi Bank	7.00%
Bank of Rajasthan	8.00%

Q.6 What is demand loan?

Ans Loan with no specific maturity date, but payable at any time. Only interest is paid until the principal is paid off, or until the lender demands repayment of principal. The borrower may, however, pay off the loan early, without incurring a prepayment penalty. If the funds are advanced to a broker, it is referred to as a call loan.

Example:
Also called a broker loan or call loan, a demand loan is granted to a brokerage house needing short-term capital for financing the margin portfolios of clients. The lending bank can demand the repayment of the loan at any time. At the same time, the brokerage house may repay a demand loan all at once without prepayment penalties. Demand loans are collateralized using securities, and interest accrues everyday at an unsecured adjustable rate.

Q.7 Write the difference between a Term Loan and demand loan?

Ans Demand Loan

Loan with no specific maturity date, but payable at any time. Only interest is paid until the principal is paid off, or until the lender demands repayment of principal. The borrower may, however, pay off the loan early, without incurring a prepayment penalty. If the funds are advanced to a broker, it is referred to as a call loan.

Term Loan

A loan from a bank for a specific amount that has a specified repayment schedule and a floating interest rate. Term loans almost always mature between one and 10 years.

Q.8 What is Export import financing?

Ans Import and export finance facility is a product designed to enhance business transactions across the country and oversea related business activities.. While for Export financing, it is purely local and the major part of the transaction is done locally.There are many benefits for a business to engage in this sort of financing. One of them is that the financing can be arranged to cover 100% of the transaction while this provides the importer with sufficient financial strength to meet up with larger orders than the amount they would do if they were relying on their own financial strength.

The biggest benefit of import and export financing is that we can provide you with the funding you need to take on new opportunities, allowing your business to go on locally and internationally.

Methods of payment-

- Cash in Advance
- Letters of Credit
- Documentary Collection
- Sight/Time Drafts
- Open Account

a) Risk mitigation:
b)Export Credit Insurance
c)Standby L/C's

Cash in Advance

1Importer pays Exporter prior to shipment.
2Exporter has no risk of non-payment or non-acceptance
3Importer has risk that exporter will not ship the goods as ordered
4Used occasionally for small amounts, new customers, one-time sales

Letter of credit-

1) Protects the interests of both Importer and the Exporter.
2) Exporter is assured payment provided terms of L/C are met.
3) Importer is assured terms of L/C have been met before she is required to pay.
4) Used for larger amounts, higher credit risks, sometimes mandated.

Documentary Collection-

1)Exporter routes documents through banking channels, where they are held for payment or acceptance

2)Less costly than a L/C and avoids tying up Importer's line of credit.
3)Average of 2 - 4 weeks for exporter to collect on a sight draft Consignment Issues.
4)Used for lower risk customers.

Open account-

- Exporter ships goods and bills the importer for payment at sight or at a future date
- Importer has use of funds, no product risk .
- Exporter has risk of non-payment.
- Risk can be shifted through credit insurance, standby L/C's .
- Used for well-established customers with good credit.

Benefits of Letters of Credit

To the Exporter:
Payment protection
Reliance on issuing bank's credit rather than buyer's
Rapid, local source of repayment, if payable at a U.S. bank
To the Importer:
Documentary evidence that the ordered goods have been shipped on time
Assurance that necessary clearance documents will be provided
Payment deferred until goods are shipped and documents presented (use of funds)

Q.9 What is Rural Banking/Lending?

Ans It is a form of banking service that provides solution to the financial needs of the consumers in rural areas.

Features of all Rural Finance Lending Products

- Repayments can be adjusted in challenging times
- Repayments structured to suit cash flow - monthly, bi-monthly, quarterly, half yearly or annually
- Internet banking
- Loan terms - flexible to a maximum 25 years with interest only periods up to 15 years

Objectives Of Banking Services In Rural Areas:

Objectives Of Banking Services In Rural Areas Poverty Alleviation Objectives: The objectives is to uplift the mass of population residing in the rural areas who are currently below the poverty line by extending credit to the smallest-scale economic activity.

Business of a rural bank:

The granting of loans and advances, particularly to small and marginal farmers and agricultural laborers, whether individual or in groups and to co-operatives societies The granting of loans and advances, particularly to artisans, small entrepreneurs and persons of small means.

Initiatives for rural banking development:

Initiatives for rural banking development Haryana State Cooperative Apex Bank Limited NABARD United Bank of India Syndicate Bank Co-operative bank

Regional Rural Banks:

Regional Rural Banks The Narasimham committee on rural credit recommended the establishment of Regional Rural Banks (RRBs). Government passed the Regional Rural Banks Act, 1976. The main objective of RRBs is to provide credit and other facilities to the small and marginal farmers, agricultural labourers and small entrepreneurs and develop agriculture, trade, commerce, industry and other productive activities in the rural areas.

RURAL SHARE OF BANKS

Bank group	Rural branches	Total branches
Public sector banks	20,398	64,673
Old private sector banks	765	5,028
New private sector banks	547	6,973
Foreign banks	7	319
Regional rural banks	11,871	16,034
Local area banks	14	53
All commercial banks	33,602	93,080

(As on March 31, 2011)
Source: Statistical table relating to banks in India 2010-11, by RBI

Objectives Of regional rural banks:
Objectives Of regional rural banks bridging the credit gap in rural areas. Check the outflow of rural deposits to urban areas. Reduce regional imbalances and increase rural employment generation

Establishment of nabard:

NABARD
COMMITTED TO RURAL PROSPERITY

Establishment of nabard National Bank for Agricultural and Rural Development was established in July 1982. The main aim was to provide credit facilities to the farmers through co-operatives & regional rural banks. They were responsible for all matters concerning policy , planning & operations in the field of credit for agricultural & other economic activities in the rural areas.

Rural Banking After Independence:
Rural Banking After Independence Pre-Nationalization period The presence of banking sector was very limited. In 1951 informal credit accounted 70% of rural lending and less than 1% of rural household debt came from commercial bank. Nationalization of banks 14 Largest Indian commercial banks were nationalized

in 1969. The central aim was to provide the banking services to all sections of society.

Q.10 What is Non performing asset?

Ans While all those assets which do not generate periodical income are called as Non-Performing Assets (NPA).In simple words, the assets of the Banks which don't perform (means don't bring any return) are called Non Performing Assets. In more general sense they are "bad Loans".

NPA is a loan or an advance where; Interest and/ or installment of principal remain overdue for a period of more than 90 days in respect of a term loan, The account remains "out of order" in respect of an overdraft/ cash credit. In case of agricultural loan when interest or principle amount remains overdue for two harvest seasons but the period not exceeding two and half years isconsidered as NPA.

Earlier assets were declared as NPA after completion of the period for the payment of total amount of loan and 30 days grace. In present scenario assets are declared as NPA if none of the installment is paid till 180 days i.e. six months in respect of a term loan.

Impact of NPAs upon Banks:

- They result in reduced interest income.
- They require higher provisioning requirements affecting profits and accretion to capital.
- They limit recycling of funds, set in assets-liability mismatches, etc.
- Adverse impact on Capital Adequacy Ratio.
- Bank's cost of raising funds goes up.

Classification of Non performing asset?

Asset or Loan Classification Norms

The assets or loans are classified as:-

1. Standard Assets
2. Sub-standard Assets
3. Doubtful Assets
4. Loss Assets

Now, in order to ensure that banks are not affected due to defaults, RBI has directed the banks to make provisions or set aside money when an account turns bad. Banks should, classify an account as NPA only if the interest due and charged during any quarter is not serviced fully within 90 days from the end of the quarter.

Asset Classification	Period for which asset remains a bad loan	Provisioning Requirement
1 Standard Asset	None as the borrower pays his dues regularly and on time	.40% of the loan amount normally
2 Sub standard asset	An asset which has remained NPA for a period less than or equal to 12 months.	Secured:15%on outstanding amount. Unsecured:25%on outstanding amount,in some cases it is 20%
Doubtful Asset a) Up to 1 year b) 1 to 3 years	An asset would be classified as doubtful if it has remained in the sub-standard category for a period of 12 months	Secured:25%of the outstanding amount. Unsecured:100%of the outstanding amount Secured:40%of the outstanding amount. Unsecured:100%of the outstanding amount Secured:100%of the outstanding amount. Unsecured:100%of the outstanding amount
Loss asset	A loss asset is one where loss has been identified by the bank or internal or external auditor or the RBI inspection but the amount not has been written off wholly .	

Q.11 How Management of Npas Occurs or what is Securitization?

Ans For the past few years, the Indian Banking system has been struggling to manage the vast portfolio of bad loans, popularly known as Non-Performing Assets (NPAs). The problem is more acute in the case of PSU banks.

Two major steps were taken in this regard -

1. The RBI directed the banks to maintain compulsory provisions for different types of NPAs;
2. The Securitization and Reconstruction of Financial Assets and Enforcement of Security Interest Act, 2002 was enacted. The SARFAESI Act allowed the banks and financial institutions to take possession of the collateral security given by the defaulting borrowers and sell these assets without having to go through protracted legal procedures.

2. Securitization

Securitization is the process of conversion of existing assets or future cash flows into marketable securities. For the purpose of distinction, the conversion of existing assets into marketable securities is known as asset-backed securitization and the conversion of future cash flows into marketable securities is known as future-flows securitization. The purpose of the Securitization Act is to promote the setting up of asset reconstruction / securitization companies to take over the Non Performing Assets (NPA) accumulated with the banks and public financial institutions. The Act provides special powers to lenders and securitization / asset reconstruction companies, to enable them to takeover of assets of borrowers without first resorting to courts.

1) Securitisation and Reconstruction of Financial Assets And Enforcement of Security Interest Act, 2002 (SARFESI) enables:

- Enforcement of security interests by secured creditors in movable (tangible or intangible, including accounts receivable) and immovable property without the intervention of court.
- Establishment of Asset Reconstruction Companies.
- Securitization of Assets.

RECOVERY STRETEGY OF NPA-

1) **Repayment of loans: -**

Repayment of term loans depends on income generating capacity of the borrowing concern. A unit, which does not earn profit, may repay a few repayments. Therefore it is necessary to fix repayment schedule for a term loan according to income generating capacity of the unit. If repayment profit, possibility may be explored in consultation with the borrowers, for replacement of the loan installments. The classification of the assets may improve, if performance of the loan account remains satisfactory for two years after repayment. It may be mentioned that repayment of the loan installments should be done only when it is expected to get payment after the repayment.

2)Rehabilitation of Potentially viable units:

If a sick unit is potentially viable, necessary efforts should be made to finalize the rehabilitation package without loss of time. Provisions need not be made for a period of one year from the date of disbursement in respect of additional facilities sanctioned under rehabilitation packages approved by BIFRV term landing institutions. If the rehabilitation program runs smoothly, it may be necessary to make provision even after one year for additional facilities provided statutory auditors are also satisfied about the progress of rehabilitation programmed.

If the unit becomes viable the entire outstanding will become standard assets. Although rehabilitation of sick units is long drawn procedure, it may be encouraged where units are potentially viable and the management is reliable. However non-viable sick units should be liquidated to get funds for recycling without avoidable loss of time in decision-making.

3) Acquisition of sick unit by healthy units:

If a healthy unit acquires a sick unit, the outstanding loan amount of sick unit may be transferred to the healthy unit and the entire NPA may be even wipedoff. Therefore banks should encourage mergers, acquisition of a sick units. Wherever they fell it may reduce the NPA'S.

4)Compromise with borrowers:

A compromise may be called a negotiated settlement in which the borrower agrees to pay a certain amount to the banker after getting certain concessions. A large number of compromise proposals are being approved by banks with a view to reducing the NPA's and recycling the funds instead of restoring to expensive recovery proceeding spread over a long period. Compromise proposals should not be approved without proper scrutiny. Banks should try to recover their dues to the maximum extent possible at minimum expense.

5)Calling up the Advances and Filing of Civil Suits:

If it is not possible to revive a unit or enter into a reasonable settlement with the borrower, it is better to recall the advance at an early stage instead of waiting for a long time which may result in deterioration of the security available. Further, if it is not possible to sell the security available without obtaining courts order, civil suits may be filled against such borrowers who are not likely to come to a reasonable settlement.

Banks should not feel that their job is over by filing civil suit. If a reasonable Settlement is possible even after filing the court case, compromise may be done With the knowledge of the court. Proper follow up of me court cases is Essential. Banks should revise the list of approved advocates from time to time Keeping in view their performance. Advocate who do not perform well should
Not be given new cases.

6) Approaching Debt Recovery Tribunals:

An act has been passed by the parliament for setting up Debt recovery tribunals for expeditious adjudication and recovery of debts due to banks and financial Institutions Act 1993, are applicable where the amount of debt due to any bank mor financial institution or to a consortium of banks or financial institution is not less than Rs 10 lacs. The central government has been empowered to reduce the lower limit of Rs 10 lacs but not beyond Rs 1 lacs by issuing a notification.

7) Recovery of Advances given under Government sponsored Programmed:

Its Banks should Take advantage of the legislation enacted by state government for speedy recovery of banks over dues. They should promptly file cases against willful defaulters with the concerned authorities of the state government by giving necessary details. The matters, relating to recovery of advances would be discussed in the state level bankers meeting and necessary help for recovery should be obtained from the state government authorities.

8) Establishment of Asset Recovery Branches:

Some banks have opened asset recovery branches at critical centers for undertaking recovery. Bad and doubtful debts of various existing branches have been transferred to the Recovery branch, which may have, expert trained staff with necessary background for recovery. The specialized recovery branches may give undivided attention to recovery of dues. Establishment of such specialized branches may help in reducing NPA'S.

9) Write off the Outstanding:

Of all the efforts for recovery fail, banks may write off the advances. Such write off should be done after exhausting all other remedies when chances of recovery are negotiable, some banks prefer to write off an advance to reduce its income and save tax. In such cases, banks should continue to make efforts for recovery even after writing off the advance

Unit 3

Central Banking Concept

Multiple Choice Questions-

1. For the development of the banking facilities in the rural areas the Imperial Bank of India was partially nationalized on—
(A) June 1, 1940
(B) June 1, 1942
(C) July 1, 1955
(D) July 1, 1949
Answer: July 1, 1955

2. The Imperial Bank of India was named as the—
(A) Reserve Bank of India
(B) State Bank of India
(C) Union Bank of India
(D) Bank of India
Answer: State Bank of India

3. Which is/are not an associated bank of SBI ?
(A) The State Bank of Hyderabad
(B) The Union Bank of India
(C) The State Bank of Bikaner and Jaipur
(D) The State Bank of Mysore
Answer: The Union Bank of India

4. In order to have more control over the banks, 14 large commercial banks whose reserves were more than Rs. 50 crore each were nationalized on—
(A) 19th July, 1969
(B) 19th July, 1970
(C) 19th July, 1971
(D) 19th July, 1972
Answer: 19th July, 1969

5. Which is not a nationalised bank ?
(A) Bank of India
(B) Canara Bank
(C) AXIS Bank
(D) Vijaya Bank
Answer: AXIS Bank

6. When the Government of India merged the New Bank of India with Punjab National Bank ?
(A) Sept. 4, 1993
(B) July 1, 1990
(C) July 1, 1993
(D) March 1, 1993
Answer: Sept. 4, 1993

7. Which is the Central Bank of India ?
(A) The Central Bank of India
(B) The State Bank of India
(C) The Reserve Bank of India
(D) The Union Bank of India
Answer: The Reserve Bank of India

8. The RBI was established in—
(A) 1935
(B) 1940
(C) 1947
(D) 1949
Answer: 1935

9. When RBI was set up, the Capital of the Bank was—
(A) 500 crore
(B) 50 crore
(C) 15 crore
(D) 5 crore
Answer: 5 crore

10. The general administration and direction of RBI is managed by a Central Board of Directors consisting of–
(A) 20 members
(B) 15 members
(C) 5 members
(D) 25 members
Answer: 20 members

11RBIwas established on ___________.
(a) April 1, 1925 (b) April 1, 1935
(c) April 1, 1945 (d) April 1, 1955
Answer: April 1, 1935

12 The one-rupee note bears the signature of____________.
(a) RBI Governor (b) Deputy Governor
(c) Finance Secretary (d) Finance Minister
Answer: Finance Secretary

13 Which among the following does the RBI not decide?
(a) CAR (b) CRR (c) Base Rate (d) Bank Rate
Answer: Base Rate

14 What does 'T' in RTGS stand for?
(a) Transaction (b) Transfer (c) Tax (d) Time
Answer: Transfer

15 In banking, IFSC code stands for_________________.
(a) International Format System Code
(b) Indian Function System Code
(c) International Forex System Code
(d) Indian Financial System Code
Answer: Indian Financial System Code

Q.1 Why there is a need of regulations?
Ans

- 1 rational for regulation-banking is a highly regulated business. Banks is a largest financial intermediary, banks touch the lives of practically every household and exercise great influence over the economic well being and growth of business entities and of entire nation.
- Custodian of saving of community. If banks mismanage their affairs ,it could result in loss of savings of millions of people as happened during the spate of failures of cooperative banks in 2004 and 2005 .
- Financial support to growth of business-banks helps in growth of business by providing financial assistance. Failures of banks can impact economic growth adversely. The lending policy of banks impacts the growth of particular industries and region.

Reserve Bank of India (RBI) is the central bank of the country and is different from Central Bank of India.

The central bank of the country is the Reserve Bank of India (RBI). It was established in April 1935 with a share capital of Rs. 5 crores on the basis of the recommendations of the Hilton Young Commission. The share capital was divided into shares of Rs. 100 each fully paid which was entirely owned by private shareholders in the begining. Reserve Bank of India was nationalised in the year 1949.

The Reserve Bank of India Act, 1934 was commenced on April 1, 1935. The Act, 1934 (II of 1934) provides the statutory basis of the functioning of the Bank.

The Bank was constituted for the need of following:

- To regulate the issue of banknotes
- To maintain reserves with a view to securing monetary stability and
- To operate the credit and currency system of the country to its advantage.

Traditional Functions of RBI -

Traditional functions are those functions which every central bank of each nation performs all over the world. Basically these functions are in line with the

objectives with which the bank is set up. It includes fundamental functions of the Central Bank. They comprise the following tasks.
Issue of Currency Notes : The RBI has the sole right or authority or monopoly of issuing currency notes except one rupee note and coins of smaller denomination. These currency notes are legal tender issued by the RBI. Currently it is in denominations of Rs. 2, 5, 10, 20, 50, 100, 500, and 1,000. The RBI has powers not only to issue and withdraw but even to exchange these currency notes for other denominations. It issues these notes against the security of gold bullion, foreign securities, rupee coins, exchange bills and promissory notes and government of India bonds.

Banker to other Banks : The RBI being an apex monitory institution has obligatory powers to guide, help and direct other commercial banks in the country. The RBI can control the volumes of banks reserves and allow other banks to create credit in that proportion. Every commercial bank has to maintain a part of their reserves with its parent's viz. the RBI. Similarly in need or in urgency these banks approach the RBI for fund. Thus it is called as the lender of the last resort.

Banker to the Government: The RBI being the apex monitory body has to work as an agent of the central and state governments. It performs various banking function such as to accept deposits, taxes and make payments on behalf of the government. It works as a representative of the government even at the international level. It maintains government accounts, provides financial advice to the government. It manages government public debts and maintains foreign exchange reserves on behalf of the government. It provides overdraft facility to the government when it faces financial crunch.

Exchange Rate Management: It is an essential function of the RBI. In order to maintain stability in the external value of rupee, it has to prepare domestic policies in that direction. Also it needs to prepare and implement the foreign exchange rate policy which will help in attaining the exchange rate stability. In order to maintain the exchange rate stability it has to bring demand and supply of the foreign currency (U.S Dollar) close to each other.

Credit Control Function : Commercial bank in the country creates credit according to the demand in the economy. But if this credit creation is unchecked or unregulated then it leads the economy into inflationary cycles. On the other credit creation is below the required limit then it harms the growth of the economy. As a central bank of the nation the RBI has to look for growth with price stability. Thus it regulates the credit creation capacity of commercial banks by using various credit control tools.

Supervisory Function : The RBI has been endowed with vast powers for supervising the banking system in the country. It has powers to issue license for setting up new banks, to open new braches, to decide minimum reserves, to inspect functioning of commercial banks in India and abroad, and to guide and direct the commercial banks in India. It can have periodical inspections an audit of the commercial banks in India.

Developmental / Promotional Functions of RBI

Along with the routine traditional functions, central banks especially in the developing country like India have to perform numerous functions. These functions are country specific functions and can change according to the requirements of that country. The RBI has been performing as a promoter of the financial system since its inception. Some of the major development functions of the RBI are maintained below.

1. **Development of the Financial System** : The financial system comprises the financial institutions, financial markets and financial instruments
2. **Development of Agriculture** : In an agrarian economy like ours, the RBI has to provide special attention for the credit need of agriculture and allied activities. It has earlier the Agriculture Refinance and Development Corporation (ARDC) to look after the credit, National Bank for Agriculture and Rural Development (NABARD) and Regional Rural Banks (RRBs).
3. **Provision of Industrial Finance** : Rapid industrial growth is the key to faster economic development. In this regard, the adequate and timely availability of credit to small, medium and large industry is very significant. In this regard the RBI has always been instrumental in setting up special financial institutions such as ICICI Ltd. IDBI, SIDBI and EXIM BANK etc.
4. **Provisions of Training**: The RBI has always tried to provide essential training to the staff of the banking industry. The RBI has set up the bankers' training colleges at several places. National Institute of Bank Management i.e NIBM, Bankers Staff College i.e BSC and College of Agriculture Banking i.e CAB are few to mention.
5. **Collection of Data** : Being the apex monetary authority of the country, the RBI collects process and disseminates statistical data on several topics. It includes interest rate, inflation, savings and investments etc. This data proves to be quite useful for researchers and policy makers.
6. **Publication of the Reports** : The Reserve Bank has its separate publication division. This division collects and publishes data on several sectors of the economy. The reports and bulletins are regularly published by the RBI. It includes RBI weekly reports, RBI Annual Report, Report on Trend and Progress of Commercial Banks India., etc. This information is made available to the public also at cheaper rates.

7. **Promotion of Banking Habits** : As an apex organization, the RBI always tries to promote the banking habits in the country. It institutionalizes savings and takes measures for an expansion of the banking network. It has set up many institutions such as the Deposit Insurance Corporation-1962, UTI-1964, IDBI-1964, NABARD-1982, NHB-1988, etc. These organizations develop and promote banking habits among the people. During economic reforms it has taken many initiatives for encouraging and promoting banking in India.
8. **Promotion of Export through Refinance** : The RBI always tries to encourage the facilities for providing finance for foreign trade especially exports from India. The Export-Import Bank of India (EXIM Bank India) and the Export Credit Guarantee Corporation of India (ECGC) are supported by refinancing their lending for export purpose.

Q.2 What is Credit Control?

Ans Credit Control is an important tool used by the Reserve Bank ofIndia, a major weapon of the monetary policy used to control the demand and supply of money (liquidity) in the economy.

Q.3 Why Credit Control is required?

Ans The basic and important needs of Credit Control in the economy are

- To encourage the overall growth of the "priority sector" i.e. those sectors of the economy which is recognized by the government as "prioritized
- To keep a check over the channelization of credit so that credit is not delivered for undesirable purposes.
- To achieve the objective of controlling "Inflation" as well as "Deflation".
- To boost the economy by facilitating the flow of adequate volume of bank credit to different sectors.

Q.4 What are the methods of Credit Control?

Ans There are two methods that the RBI uses to control the money supply in the economy-

(1) Qualitative Method: By qualitative methods means the control or management of the uses of bank credit or manner of channelizing of cash and credit in the economy. Tools used under this method are:

Marginal Requirement: Marginal Requirement of loan can be increased or decreased to control the flow of credit for e.g. – a person mortgages his property worth Rs. 1,00,000 against loan. The bank will give loan of Rs. 80,000 only. The marginal requirement here is 20%. In case the flow of credit has to be increased, the marginal requirement will be lowered.

Rationing of credit: Under this method there is a maximum limit to loans and advances that can be made, which the commercial banks cannot exceed.

Publicity: RBI uses media for the publicity of its views on the current market condition and its directions that will be required to be implemented by the commercial banks to control the unrest.

Direct Action: Under the banking regulation Act, the central bank has the authority to take strict action against any of the commercial banks that refuses to obey the directions given by Reserve Bank of India.

Moral Suasion: This method is also known as "Moral Persuasion" as the method that the Reserve Bank of India, being the apex bank uses here, is that of persuading the commercial banks to follow its directions/orders on the flow of credit.

(2) **Quantitative Method:** By Quantitative Credit Control we mean the control of the total quantity of credit. Different tools used under this method are:
Bank Rate: Bank Rate also known as the Discount Rate is the official minimum rate at which the Central Bank of the country is ready to rediscount approved bills of exchange or lend on approved securities.
When the commercial bank for instance, has lent or invested all its available funds and has little or no cash over and above the prescribed minimum, it may ask the central bank for funds. It may either re-discount some of its bills with the central bank or it may borrow from the central bank against the collateral of its own promissory notes.
In either case, the central bank accommodates the commercial bank and increases the latter's cash reserves. This Rate is increased during the times of inflation when the money supply in the economy has to be controlled.
Open Market Operations: Open Market Operations indicate the buying/selling of government securities in the open market to balance the money supply in the economy. During inflation, RBI sells the government securities to the commercial banks and other financial institution. This reduces their cash lending and credit creation capacities. Thus, Inflation can be controlled. During recessions, RBI purchases government securities from commercial banks and other financial institution. This leaves them with more cash balances for lending and increases their credit creation capacities. Thus, recession can be overcome.
Repo Rates and Reverse Repo Rates: Repo is a swap deal involving immediate sale of securities and a simultaneous re purchase of those securities at a future date at a predetermined price. Commercial banks and financial institution also park their funds with RBI at a certain rate, this rate is called the Reverse Repo Rate. Repo rates and Reverse repo rate used by RBI to make liquidity adjustments in the market.
Cash Reserve Ratio: The money supply in the economy is influenced by the cash reserve ratio. It is the ratio of a bank's time and demand liabilities to be kept in

reserve with the RBI. A high CRR reduces the flow of money in the economy and is used to control inflation. A low CRR increases the flow of money and is used to overcome recession.

Statutory Liquidity Ratio: Under SLR, banks have to invest a certain percentage of its time and demand liabilities in Government approved securities. The reduction in SLR enhances the liquidity of commercial banks.

Deployment of Credit: The RBI has taken various measures to deploy credit in different of the economy. The certain percentage of bank credit has been fixed for various sectors like agriculture, export, etc.

Supervisory Functions of RBI -

The Reserve Bank Act, 1934, and the Banking Regulation Act, 1949 have given the RBI wide powers of supervision and control over commercial and co-operative banks, relating to licensing and establishments, branch expansion, liquidity of their assets, management and methods of working, amalgamation, reconstruction, and liquidation. The RBI is authorised to carry out periodical inspections of the banks and to call for returns and necessary information from them.

The supervisory functions of the RBI have helped a great deal in improving the standard of banking in India to develop on sound lines and to improve the methods of their operation.

The reserve bank also performs many supervisory functions. It has authority to regulate and administer the entire banking and financial system. Some of its supervisory functions are given below.

1. Granting license to banks : The RBI grants license to banks for carrying its business. License is also given for opening extension counters, new branches, even to close down existing branches.
2. Bank Inspection : The RBI grants license to banks working as per the directives and in a prudent manner without undue risk. In addition to this it can ask for periodical information from banks on various components of assets and liabilities.
3. Control over NBFIs : The Non-Bank Financial Institutions are not influenced by the working of a monitory policy. However RBI has a right to issue directives to the NBFIs from time to time regarding their functioning. Through periodic inspection, it can control the NBFIs.
4. Implementation of the Deposit Insurance Scheme : The RBI has set up the Deposit Insurance Guarantee Corporation in order to protect the deposits of small depositors. All bank deposits below Rs. One lakh are insured with this corporation. The RBI work to implement the Deposit Insurance Scheme in case of a bank failure.

Q.5 What are reforms in Indian banking-

Ans Narasimham Committee Report I – 1991-RBI proposed the committee chaired by M.Narasimham, former RBI Governor to review the Financial System ‡Review- aspects relating to the Structure, Organization, Procedures and Functioning of the financial system Constituted in 1991, the Committee submitted two reports, in 1992 and 1998, which laid significant thrust on enhancing the efficiency and viability of the banking sector. T he Narasimham Committee laid the foundation for the reformation of the Indian banking sector.

Narasimham Committee Report II – 1998-In 1998 the government appointed yet another committee under the chairmanship of Mr. Narsimham. It is better known as the Banking Sector Committee. It was told to review the banking reform progress and design a programme for further strengthening the financial system of India. The committee focused on various areas such as capital adequacy, bank mergers, bank legislation, etc.

Problems Identified By The Narasimham Committee

1. **Directed Investment Programme** : The committee objected to the system of maintaining high liquid assets by commercial banks in the form of cash, gold and unencumbered government securities. It is also known as the statutory liquidity Ratio (SLR). In those days, in India, the SLR was as high as 38.5 percent. According to the M. Narasimham's Committee it was one of the reasons for the poor profitability of banks. Similarly, the Cash Reserve Ratio- (CRR) was as high as 15 percent. Taken together, banks needed to maintain 53.5 percent of their resources idle with the RBI.
2. **Directed Credit Programme** : Since nationalization the government has encouraged the lending to agriculture and small-scale industries at a confessional rate of interest. It is known as the directed credit programme. The committee opined that these sectors have matured and thus do not need such financial support. This directed credit programme was successful from the government's point of view but it affected commercial banks in a bad manner. Basically it deteriorated the quality of loan, resulted in a shift from the security oriented loan to purpose oriented. Banks were given a huge target of priority sector lending, etc. ultimately leading to profit erosion of banks.
3. **Interest Rate Structure** : The committee found that the interest rate structure and rate of interest in India are highly regulated and controlled by the government. They also found that government used bank funds at a cheap rate under the SLR. At the same time the government advocated the philosophy of subsidized lending to certain sectors. The committee felt that there was no need for interest subsidy. It made banks handicapped in terms of building main strength and expanding credit supply.
4. **Additional Suggestions** : Committee also suggested that the determination of interest rate should be on grounds of market forces. It further suggested minimizing the slabs of interest.

The Narsimhan committee I has given the following major recommendations:-

1. Reduction in the SLR and CRR : The committee recommended the reduction of the higher proportion of the Statutory Liquidity Ratio 'SLR' and the Cash Reserve Ratio 'CRR'. Both of these ratios were very high at that time. The SLR then was 38.5% and CRR was 15%. This high amount of SLR and CRR meant locking the bank resources for government uses. It was hindrance in the productivity of the bank thus the committee recommended their gradual reduction. SLR was recommended to reduce from 38.5% to 25% and CRR from 15% to 3 to 5%.
2. Phasing out Directed Credit Programme : In India, since nationalization, directed credit programmes were adopted by the government. The committee recommended phasing out of this programme. This programme compelled banks to earmark then financial resources for the needy and poor sectors at confessional rates of interest. It was reducing the profitability of banks and thus the committee recommended the stopping of this programme.
3. Interest Rate Determination : The committee felt that the interest rates in India are regulated and controlled by the authorities. The determination of the interest rate should be on the grounds of market forces such as the demand for and the supply of fund. Hence the committee recommended eliminating government controls on interest rate and phasing out the concessional interest rates for the priority sector.
4. Structural Reorganizations of the Banking sector : The committee recommended that the actual numbers of public sector banks need to be reduced. Three to four big banks including SBI should be developed as international banks. Eight to Ten Banks having nationwide presence should concentrate on the national and universal banking services. Local banks should concentrate on region specific banking. Regarding the RRBs (Regional Rural Banks), it recommended that they should focus on agriculture and rural financing. They recommended that the government should assure that henceforth there won't be any nationalization and private and foreign banks should be allowed liberal entry in India.
5. Establishment of the ARF Tribunal : The proportion of bad debts and Non-performing asset (NPA) of the public sector Banks and Development Financial Institute was very alarming in those days. The committee recommended the establishment of an Asset Reconstruction Fund (ARF). This fund will take over the proportion of the bad and doubtful debts from the banks and financial institutes. It would help banks to get rid of bad debts.
6. Removal of Dual control : Those days banks were under the dual control of the Reserve Bank of India (RBI) and the Banking Division of the Ministry of Finance (Government of India). The committee recommended the stepping of this system. It considered and recommended that the RBI should be the only main agency to regulate banking in India.
7. Banking Autonomy : The committee recommended that the public sector banks should be free and autonomous. In order to pursue competitiveness and

efficiency, banks must enjoy autonomy so that they can reform the work culture and banking technology upgradation will thus be easy.

Narsimhan committee II in 1998 with the following recommendations.

1. Strengthening Banks in India : The committee considered the stronger banking system in the context of the Current Account Convertibility 'CAC'. It thought that Indian banks must be capable of handling problems regarding domestic liquidity and exchange rate management in the light of CAC. Thus, it recommended the merger of strong banks which will have 'multiplier effect' on the industry.
2. Narrow Banking : Those days many public sector banks were facing a problem of the Non-performing assets (NPAs). Some of them had NPAs were as high as 20 percent of their assets. Thus for successful rehabilitation of these banks it recommended 'Narrow Banking Concept' where weak banks will be allowed to place their funds only in short term and risk free assets.
3. Capital Adequacy Ratio : In order to improve the inherent strength of the Indian banking system the committee recommended that the Government should raise the prescribed capital adequacy norms. This will further improve their absorption capacity also. Currently the capital adequacy ration for Indian banks is at 9 percent.
4. Bank ownership : As it had earlier mentioned the freedom for banks in its working and bank autonomy, it felt that the government control over the banks in the form of management and ownership and bank autonomy does not go hand in hand and thus it recommended a review of functions of boards and enabled them to adopt professional corporate strategy.
5. Review of banking laws : The committee considered that there was an urgent need for reviewing and amending main laws governing Indian Banking Industry like RBI Act, Banking Regulation Act, State Bank of India Act, Bank Nationalisation Act, etc. This upgradation will bring them in line with the present needs of the banking sector in India.

Apart from these major recommendations, the committee has also recommended faster computerization, technology up gradation, training of staff, depoliticizing of banks, professionalism in banking, reviewing bank recruitment, etc.

Unit 4
Fundamentals of Investment Banking

Multiple Choice Questions

1. The place where bankers meet and settle their mutual claims and accounts is known as –
a) Treasury
b) Clearing House
c) Dumping House
d) Collection centre
Ans. b) Clearing House

2. The largest Public sector bank in India –
a) SBI
b) PNB
c) RBI
d) ICICI
Ans. a) SBI

3. Which of the following is not the function of RBI –
a) Banker's bank
b) Banker to public
c) custodian of foreign exchange
d) Bankers to Govt.
Ans. b) Banker to public

4. Who is responsible for the collection and publication of monetary and financial information-
a) Finance Commission
b) Finance ministry
c) RBI
d) Auditor and Comptroller general of India
Ans. c) RBI

5. Which of the following regulatory authority to oversee the new issues, protect the investment and investors, promote the development of Capital Market and regulate the working of Stock Exchange –

a) UTI b) IRDA
c) RBI
d) SEBI
e) None of these
Ans. d) SEBI

6. After a long span of 22 years, RBI released Rs.1000/- currency note for circulation in –
a) 2000
b) 2002
c) 2005
d) 2008
Ans. a) 2000

7. Regional Rural banks are working in all states of the country except –
a) Sikkim and Goa
b) Sikkim and Manipur
c) Manipur and Nagaland
d) Jammu and Kashmir
Ans. a) Sikkim and Goa

8. The National Housing Bank is a subsidiary of –
a) RBI
b) NABARD
c) IDBI
d) UTI
Ans. a) RBI

9. At present the ceiling of Foreign Direct Investment (FDI) in insurance sector in India is –
a) 26%
b) 49%
c) 51%
d) 74%
Ans. a) 26%

10. Rs. 25 Paisa was ceased by the Govt of India on –
a) 30th june 2011
b) 30th July 2011
c) 1st January 2011
d) 1st July 2011
Ans. a) 30th june 2011

11. Initial Public Offering (IPO) is associated with –
a) RBI
b) Stock Exchange
c) IRDA
d) Indian Postal Service
Ans. b) Stock Exchange

12. The Basic regulatory authority for mutual funds and stock markets lies with the –
a) Government of India
b) Reserve Bank of India
c) Securities and Exchange Board of India (SEBI)
d) Stock Exchange
Ans. c) Securities and Exchange Board of India (SEBI)

13. Monetary policy Refers to the policy of –
a) Money Lenders
b) Government
c) Commercial Banks
d) RBI
Ans. d) RBI

Q.1 What is the Fundamentals of Investment Banking?

Ans

Fee Based & Fund Based Services

Traditionally, the financial intermediaries have been rendering a wide range of services encompassing both capital and money market activities. They can be grouped under two heads-
a. Fund based activities and
b. Non-fund based activities.

Fund Based Services

In fund-based services the firm raises funds through debt, equity, deposits and the bank invests the funds in securities or lends to those who are in need of capital. We will be discussing here some of these fund-based services such as:
a) Leasing and Hire Purchase
b) Housing Finance
c) Credit Cards
d) Venture Capital
e) Factoring
f) Forfeiting
g) Bill Discounting
h) Insurance

Fund based activities: The traditional services which comeunder fund based activities are the following:

i. Underwriting or investment in shares, debentures, bonds, etc. of new issues (primary market activities).

ii. Dealing in secondary market activities.

iii. Participating in money market instruments like commercial papers, certificate of deposits, treasury bills, discounting of bills etc.

iv. Involving in equipment leasing, hire purchase, venture Capital, seed capital.

v. Dealing in foreign exchange market activities.

N on fund based/Fee Based activities: Financial intermediaries provideservices on the basis of non-fund activities also. This can be called 'fee based' activity. Today customers, whether individual or corporate, are not satisfied with mere provisions of finance. They expect more from financial services companies. Hence a wide variety of services, are being provided under this head.

They include:

i. Managing the capital issue – i.e. management of pre-issue and post-issue activities relating to the capital issue in Accordance with the SEBI guidelines and thus enabling the promoters to market their issue.

ii. Making arrangements for the placement of capital and debt Instruments with investment institutions.

iii. Arrangement of funds from financial institutions for the clients' project cost or his working capital requirements.

iv. Assisting in the process of getting all Government and other clearances.

Fee Based Services-

Fee based financial services are those services wherein financial institutions operate in specialized fields to earn a substantial income in the form of fees or dividends or brokerage on operations. The major fee based financial services are as follow:

a) Issue Management
b) Corporate Advisory Services
c) Credit Rating
d) Mutual Funds
e) Asset Securitization
f) Stock Broking Services

Q.2 What are innovations in Indian banking?

Ans E-banking-Electronic banking, also known as e-banking, virtual banking and online banking, is a service that allows customers to access their bank information, conduct financial transactions, make deposits, withdrawals and pay bills through the Internet without having to physically visit their bank. It provides the convenience of accessing banking facilities from the comfort of their home or office.

Online banking through traditional banks enable customers to perform all routine transactions, such as account transfers, balance inquiries, bill payments, and stop-payment requests, and some even offer online loan and credit card applications. Account information can be accessed anytime, day or night, and can be done from anywhere. A few online banks update information in real-time, while others do it daily.

The popular services covered under E-banking include:-

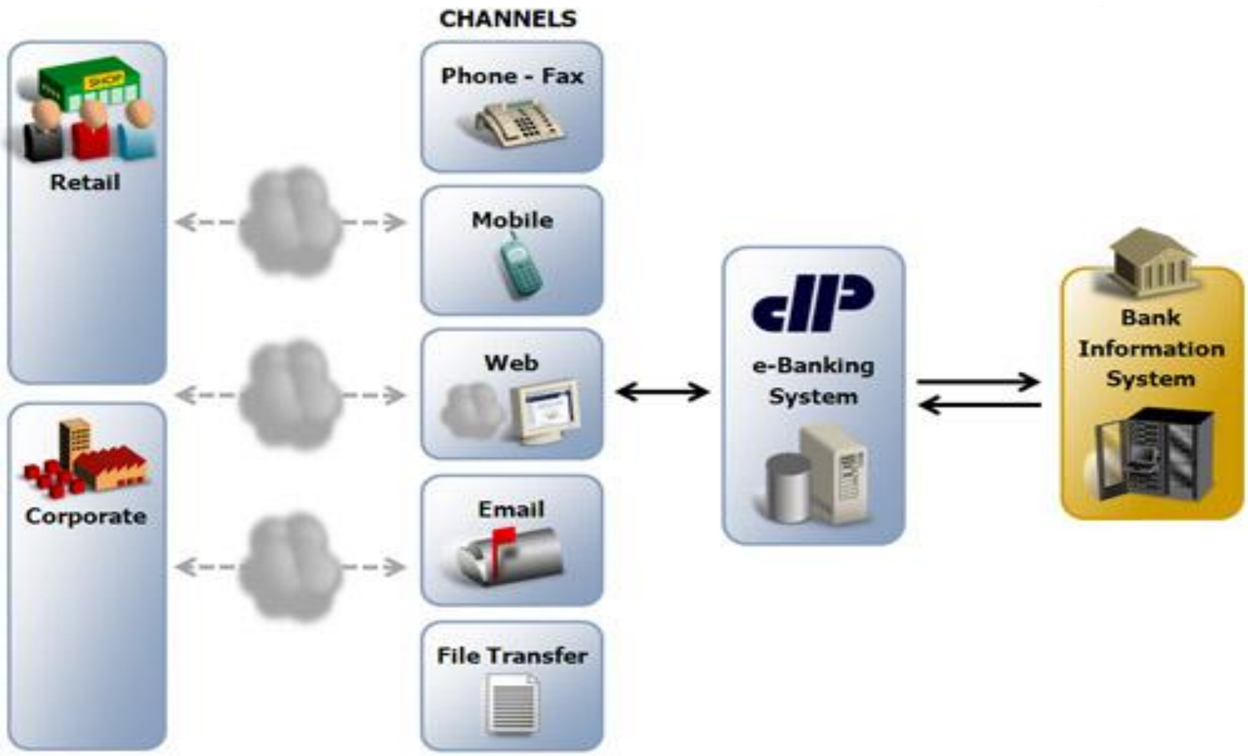
- Automated Teller Machines,
- Credit Cards,
- Debit Cards,
- Smart Cards,
- Electronic Funds Transfer (EFT) System,
- Cheques Truncation Payment System,
- Mobile Banking,
- Internet Banking,
- Telephone Banking, etc.

Advantages of E-Banking -

<u>The main advantages of E-banking are</u> :-

- The operating cost per unit services is lower for the banks.
- It offers convenience to customers as they are not required to go to the bank's premises.
- There is very low incidence of errors.
- The customer can obtain funds at any time from ATM machines.
- The credit cards and debit cards enables the Customers to obtain discounts from retail outlets.
- The customer can easily transfer the funds from one place to another place electronically.


e
Banking


CHANNELS
Retail
Corporate
Phone - Fax
Mobile
Web
Email
File Transfer
e-Banking
System
Bank
Information
System

Unit 5
Introduction to NBFCs

Multiple Choice Questions-

1. Which of the following statements is true?
a) The licence to open branches of bank is granted by Board of Directors of that Bank
b) There is no need of licenses to open branch of a bank
c) A licence to open a branch is issued by the Central Government
d) A licence to open a branch is issued by the Reserve Bank of India under the provisions of Banking Regulation Act, 1949

2. The important condition for granting licence of banking companies is?
a) Banking company need not plan to pay for future depositors
b) Banking company can plan for its capital structure once the licence is granted
c) The business undertaken by the banking company should not frustrate the interest of public
d) The banking company can undertake business other than banking with the permission of annual general body

3. Who of the following is not a party to the IPO?
a) Registrar of Issue
b) Investment Banker
c) Advertisement Agency
d) Registrar of Companies

4. Which of the following is not shown as an asset in the balance sheet of a Bank?
a) Investments
b) Advances
c) Cash Balances with other banks
d) Borrowings

5. The credit policy of a bank does not consists of?
a) Lending policies
b) Quality control
c) Loan product mix
d) Advertising of loan products

6. Which of the following is a function of the agent bank relating to flow of money in the process of loan syndication?
a) Receiving notices relating to cancellation of any part of the loan
b) Calling of loans in the event of default
c) Receiving the fee from the borrower and distributing among the participating banks
d) Receiving notices relating to transfers of banks

7. Which of the following is the parameter to recognize the SSI unit as sick unit?
a) The erosion in the net-worth due to accumulated losses is up to 25% of its net worth during the previous account year
b) The erosion in the net-worth due to accumulated losses is up to 50% of its net worth during the previous account year.
c) The unit should have been in commercial production for at least five years
d) Lack of updations in technological development

8. Which of the following is not the service provided by the Small Industries Service Institute?
a) Providing entrepreneurship development programs
b) Developmental efforts
c) Export promotion and liaison activities
d) Financial support

9. Service Area Approach (SAA) is associated with?
a) Rural and Semi-urban branches of commercial banks
b) Urban branches of commercial banks
c) Branches of commercial banks situated in metro cities
d) Development banks

10. Which of the following cannot be securitized?
a) Future rentals of a fishing boat
b) Hire purchase receivables
c) Demand drafts received by the banker during clearing
d) Future billings for an airline

11. Which of the following statements is true?
a) The special purpose vehicle (SPV) purchases the assets from the borrower directly during the securitization
b) The originator and obligor are the same persons in securitization process
c) Administrator collects the payments due from the obligor and passes it to the SPV and follows with defaulters
d) Mortgage based securitization provides high yields to the investor

12. The important feature of an anticipatory letter of credit is that?
a) The letter of credit can be used as back- to- back letters of credit
b) The beneficiary under the letter of credit may receive payment even at the pre-shipment stage
c) The beneficiary under the letter of credit may receive payment even at the post-shipment stage
d) The cash advance is not permitted against such letter of credits

13. The Shipping guarantee is a?
a) Type of a letter of credit
b) Guarantee issued by the ship captain to the purchaser
c) Guarantee issued to the borrower towards the loan granted by the shipping company
d) Deferred payment guarantee issued by a banker at the request of the consignee when the documents are not received and goods are received, for facilitating the delivery of goods.

14. Which of the following statements is true?
a) The charge card is a credit instrument
b) Under this facility the cardholders need to pay amount within ten installments
c) Cardholder has to pay the 100% of the purchase amount within 30 days of purchase
d) The charge card shall have revolving credit

15. Which of the following is not augmented feature of a credit card?
a) Personal accident insurance
b) Cash withdrawals
c) Add-on facility
d) Issue of deferred guarantee

16. Which of the following is the disadvantage of going for public issue?
a) Liquidity to existing shares
b) Increase in visibility and reputation to the company
c) Better pricing and placement with new investors
d) Need to make continuous disclosures

17. Which of the following is not a criterion to select the Investment Bankers?
a) No professional memberships or incorporations are required
b) General reputation in the market
c) Good rapport with market intermediaries
d) Distribution net work of the organization

18. Which of the following is not an asset of a bank?
    a) Notes and small coins
    b) Overdue recurring deposits
    c) Short term loans
    d) Staff advances

19. The banking company has restriction to sanction loan to?
    a) Directors of the bank
    b) Staff working in the bank
    c) Students going abroad
    d) Professionals

20. Which of the following is a non-depository institution?
    a) Credit unions
    b) Commercial banks
    c) Mutual funds
    d) Regional rural banks

Answers1) d 2) c 3) d 4) d 5) d 6) c 7) b 8) d 9) a 10) c
11) c 12) b 13) d 14) c 15) d 16) d 17) a 18) b 19) a 20) c

Q.1 Write an introduction to NBFC?

Ans Non-Banking Financial Company has been defined as

(i) A non-banking institution, which is a company and which has its principal business the receiving of deposits under any scheme or lending in any manner.

(ii) Such other non-banking institutions, as the bank may with the previous approval of the central government and by notification in the official gazette, specify.

NBFCS provide a range of services such as hire purchase finance, equipment lease finance, loans, and investments. NBFCS have raised large amount of resources through deposits from public, shareholders, directors, and other companies and borrowing by issue of non-convertible debentures, and so on. Non-banking Financial Institutions carry out financing activities but their resources are not directly obtained from the savers as debt. Instead, these Institutions mobilize the public savings for rendering other financial services including investment. All such Institutions are financial intermediaries and when they lend, they are known as Non-Banking Financial Intermediaries (NBFIs) or Investment Institutions:

- UNIT TRUST OF INDIA.

- LIFE INSURANCE CORPORATION (LIC).
- GENERAL INSURANCE CORPORATION (GIC)

Q. 2. NBFCs are doing functions similar to banks. What is difference between banks & NBFCs ?

Ans NBFCs lend and make investments and hence their activities are akin to that of banks; however there are a few differences as given below:

i. NBFC cannot accept demand deposits;

ii. NBFCs do not form part of the payment and settlement system and cannot issue cheques drawn on itself.

iii. Deposit insurance facility of Deposit Insurance and Credit Guarantee Corporation is not available to depositors of NBFCs, unlike in case of banks.

Q.3 What is the role of NBFCs?

Ans NBFCs have seen considerable business model shift over last decade because of regulatory environment and market dynamics. Majority of NBFCs were not able 00to face the pressure created on, and were wiped out. However, since 2001-2002, there has been significant improvement in the business model of existing NBFCs.

As recognized by RBI and expert committee's role of NBFCs include--

- Development of sectors like Transport & Infrastructure
- Substantial employment generation
- Help & increase wealth creation
- Broad base economic development
- Irreplaceable supplement to bank credit in rural segments
- major thrust on semi-urban, rural areas & first time buyers / users
- To finance economically weaker
- Huge contribution to the State exchequer.

<u>70-80% of Commercial Vehicles are finance driven</u>

- Indian economy is more dependent on roads
- Heavy Govt. outlay for mega road projects
- Heavy replacement demand anticipated – 30 lacs commercial vehicles by the year 2007
- Another Rs.6000 Crores required for phasing out old commercial vehicles
- CRISIL in its study has placed commercial vehicle financing under "low risk" category
- Each commercial vehicle manufactured, sold and financed gives employment to minimum 20 persons (direct and indirect).

Q.4 Write the Classification of NBFCs?

Ans Classification of NBFCs

- Equipment Leasing Company
- Hire Purchase Company
- Investment Company Loan Company
- Miscellaneous Non-Banking Companies

1. Equipment Leasing Company Equipment Leasing Company means the company which is a financial institution carrying on the activity of leasing of equipments as its main business.

2. Hire Purchase Company It is a company which is a financial institution carrying on its main activity as hire purchase transactions or the financing of such transactions.

3. Investment Company It means a company which is a financial institution carrying on as its main business of the acquisition of securities.

4. Loan Company It means any company which is a financial institution carrying on as its main business by providing finance whether by making loans or advances.

5. Miscellaneous Non-Banking Companies Miscellaneous Non-Banking

Companies are the companies engaged in the chit fund business.
Asset finance co.(AFC) and Infrastructure finance co.(IFC)-
AFC: Financing of physical assets supporting productive economic activities such as automobiles, tractors, earth moving machinery, lathe machines, generator sets, material handling equipment and general purpose industrial machinery.
IFC: long term funding for developing or operating and maintaining or developing, operating and maintaining any infrastructure project in road, highway, port, airport inland port, waterways, water supply, irrigation project, water treatment, sanitation and sewage system or solid waste management, telecom services (basic or cellular), network and internet service, transmission or distribution of power, laying down and maintenance of gas, crude oil and petroleum pipelines.

Case Study-NBFCS

Case study of MUTHOOD FINANCE

Muthoot Finance Ltd is the largest gold company in India. The company provides personal and business loans secured by gold jewellery, or Gold Loans, primarily to individuals who possess gold jewellery but could not access formal credit within a reasonable time, or to whom credit may not be available at all, to meet unanticipated or other short-term liquidity requirements.

The company is headquartered in Kerala. In addition to their Gold Loans 1business, the company provides money transfer services through their branches as sub- agents of various registered money transfer agencies. They have commenced providing collection agency services. They also operate three windmills of 1.25 MW each in the state of Tamil Nadu.

Muthoot Finance Ltd was incorporated on March 14, 1997 as a private company with the name The Muthoot Finance Pvt Ltd. The company is promoted by M G George Muthoot, George Thomas Muthoot, George Jacob Muthoot and George Alexander Muthoot. The company's operating history evolved over a period of 70 years since M George Muthoot (the father of the promoters) founded a gold loan business in 1939 under the heritage of a trading business established by his father, Ninan Mathai Muthoot, in 1887.

In the year 2001, the company obtained the license from RBI to function as an NBFC. In the year 2005, as per the scheme of amalgamation, Muthoot Enterprises Private Ltd was amalgamated with the company with effect from March 22, 2005. In May 16, 2007, the name of the company was changed from The Muthoot Finance Pvt Ltd to Muthoot Finance Pvt Ltd.

During the year 2008-09, the company opened 278 new branches across various states. Also, they opened regional offices in Sales and Visakhapatnam. In November 18, 2008, the company was converted into public limited company and the name was changed to Muthoot Finance Ltd. They obtained fresh RBI license to function as an NBFC without accepting public deposits, consequent to change in name. During the year 2009-10, the company added 620 new branches.

As per the scheme of de-merger, the radio business of the company was de-merged and transferred to Muthoot Broadcasting Pvt Ltd with effect from January 01, 2010. The company opened 316 new branched between April 2010 to August 2010. As of August 31, 2010, they had 1,921 branches located in 20 states and two union territories in India. The

company intends to continue to grow their loan portfolio by expanding their network through the addition of new branches.

Business Divisions:-

1)Finance

Muthoot Finance Ltd: Established in the year 1939 when M.George Muthoot ventured into financial services through a partnership firm under the name of Muthoot M. George & Brothers (MMG). MMG was a Chit Fund based out of Kozhencherry. In 1971, the firm was renamed as Muthoot Bankers, and had begun to finance loans using gold jewellery as collateral. . In 2001, the company was renamed once again and came to be known as Muthoot Finance Ltd.. Muthoot Finance falls under the category of Systematically Important Non- banking financial company(NBFC) of the RBI guidelines.

The company has more than 4,050 branches spread across 23 states of the country Muthoot Finance, according to the IMaCS Research & Analytics Industry Reports [Gold Loans Market in India, 2009 and the 2010 update to the IMaCS Industry Report 2009], is the largest Gold Loan NBFC and has the largest network of branches for a Gold Loan NBFC in India.[4] Muthoot Finance is also the highest credit rated Gold Loan company in India, with a credit rating of AA- (CRISIL) and LAA-(ICRA) for its Long Term Debts and P1+ (CRISIL) & A1+ (ICRA) for its Short Term Debt Instruments.

Muthoot Finance promotes "gold power", a concept which emphasizes mobilizing household Gold possessions (ornaments), estimated to be more than 20000 tonnes, in times of financial crunch. The services can be used by anyone from any economic section of society, with minimal paperwork and hindrances. Muthoot Finance privately placed 4% of its paid up capital to Private Equity players - Barings India and Matrix Partners India for Rs.1.57 billion, hence valuing the earlier privately held company at over $1 billion. In terms of market capitalization, Muthoot Finance Ltd is the second largest company in Kerala, first being Federal Bank.

Information Technology

Muthoot Systems and Technologies Pvt Ltd: Operating under the brand Emsyneis the Information technology arm of the Muthoot Group, is headquartered in Cochin. The company has been operating for over the past 14 years in the IT sector. Their client list includes US companies such as ARC group, PA, Court Port LLC, SVM, JAL International. The company was established in 1993. It offers Information Technology services, Product Engineering Solutions, Business Process Outsourcing Services and Consultancy Services to local as well as Global clients. The company has recently started its operations in US with a subsidiary in Philadelphia region. Expansion into other regions of the US and The Middle East is planned.

Vehicle and Asset Financing

Muthoot Vehicle & Asset Finance Ltd.: Incorporated in 1992 and renamed as Muthoot Vehicle & Asset Finance Ltd. in 2008, this division of the Muthoot Group is the sole company of its kind in Kerala. The RBI certification classifies it as a Deposit taking Asset Finance Company.

Power Generation

Muthoot Alternate Energy Resources: Established in 2006 Muthoot power generation division (which comes under Muthoot Finance Ltd.) runs 3, 1.25 MW capacity Suzlon Make Wind Electric Generators at Devarkulam site in Tirunelveli District, Tamil Nadu. The WEGs generate 8 million unit of power annually which is pumped into the Southern grid.

Wealth Management Services

This division of the Group is associated with an array of insurance solutions ranging from life insurance to medical, ULIPs, etc. It was established in 2002.

Plantations and Estates

The Muthoot Group operates this division on a large scale. Established in 1939, The plantations grow cardamom, tea, coconut and rubber. The division also undertakes a number ofeco-friendly initiatives.

Global Operations

Muthoot Global is a part of Muthoot Group with presence in UAE, USA and UK, currently dealing in Gold Loans, Money Transfer, Travel & Tourism and ecommerce. UAE operations commenced in the year 2002, UK operations started in 2007 and USA in 2010.

Findings:-

Muthoot finance provided personal and business loan secured by Gold Jewellery, or Gold Loans, primarily to individuals who possess gold jewellery but could not access formal credit within a reasonable time, or to whom credit may not be available at all, to meet unanticipated or other short-term liquidity requirements.

CONCLUSION

From the above study we can conclude that the non banking financial companies also contribute to the major part of our economy. Muthooth Finance is also such a NBFC which is having wide range of such a application.

Recent Trends In Banking Sector

1) Mahindra Rural Housing Finance Ltd (MRHFL), Mahindra Group's rural housing finance arm, is planning to raise about Rs 200 crore for expansion. By 2015, the company aims to increase its book size about three-fold to Rs 4,000 crore. To meet this target, the company plans to expand its business from seven states to 12-13

2)Bank of India is going to take up rural and suburban lending in a big way to harness the credit potential of agrarian community.

3) From march 2014 all kisan credit cards are converted to ATMs.

4) Banking licence would be given to NBFCs and business houses like reliance, TATA.

5)India Post is keen to set up a commercial bank called the Post Bank of India, arguing that it can significantly boost financial inclusion in Asia's third largest economy through its nationwide network of 155,000 post offices.

6)State-owned Indian Bank has introduced account portability feature which allows its customers to retain the account number even if they change the branch.The facility would enable the customer to have the freedom of operating his or her account from any of the branches, Indian Banks.

13 banking trends for 2013-

1. **Analytics gets real time, and mobility is a priority**
   Banks will combine existing and real-time information of a customer, transaction and product to integrate it with applications like location-based services.

2. **The core evolves from transaction to intelligence**
   Transaction history will emerge as a way to identify new product / service requirements or push contextual offers.
3. **Time to cash in the chips on gamification**
   Banks look to tap into the virtual gaming ecosystem or charge a fee for facilitating end-to-end payments of virtual currencies.
4. **Socializing pays off with a new revenue stream**
   Social media goes from customer care to new selling opportunities – powered by peer recommendations, personalized services, and co-creation of products.
5. **Banker, retailer, telco, technologist: the new gang of four.**
   Banks go from collaboration to co-creation, with new services and products that combine offerings from banking and non-banking entities.
6. **The teller is a jolly good seller**
   A shift in mindset and training programs help tellers become trusted salespersons who understand customer needs and proactively recommend new services.
7. **65 plus is easier to serve than 30 minus**
   The rush to woo Gen Y customers will be coupled with increased focus on senior citizens globally – as they have considerable savings, want simple products, and are less likely to jump ship.
8. **Life stage banking gets overlaid with lifestyle banking**
   All customers at the same life stage like education or marriage may not have the same needs — their lifestyle – influenced by geography, culture and interests – will define their banking solutions.
9. **Baby steps, not big bang: progressive modernization**
   Use a phased approach to avoid disruption and experience the possibilities with projects for new channels, customer segments, and lines of business.
10. **Try some real estate on the cloud**
    Use one of the big three – infrastructure, platform, or software as a service – to test the 'cloudability' of areas like end-user computing, payroll processing, or procurement.
11. **If IT is a problem, IT is also the solution**
    Those grappling with legacy systems need creative thinking to build new self-healing IT layers that simplify processes and increase automation.
12. **In search of the right outsourcing model**
    Rather than outsourcing everything or not outsourcing at all, banks need to outsource the right processes to the right IT or BPO partners.
13. **Mobility: the ultimate troubleshooting device**
    The ubiquity of mobile devices can be a great way to access and address IT problems 'anytime, anywhere' — solving not just their issues, but also those of their customers

Key Terms

AER – Annual earnings rate on an investment.

APR – The annual percentage rate of interest, usually on a loan or mortgage, usually displayed in brackets and representing the true cost of the loan or mortgage as it shows any additional payments beyond the interest rate.

Bank Statements – This is a statement from the bank giving details of transactions in the relevant account. It can be requested at any intervals required, usually monthly.

Bounced Cheque – when the bank has not enough funds in the relevant account or the account holder requests that the cheque is bounced (under exceptional circumstances) then the bank will return the cheque to the account holder. The beneficiary of the cheque will have not been paid. This normally incurs a fee from the bank.

Bonds – These are securities which pay interest at specified intervals and the principle amount of the loan is paid at maturity.

Charges – This is the money paid to the bank for services rendered. Charges include overdraft fees, charges for bouncing cheques, interest on overdraft and any charges that a business account might normally incur.

Charge Cards – Cards which can be used like a credit card but the charge has to be paid off on the due date. They usually have a high limit or no limit.

Clearing Bank – This is a bank that can clear funds between banks. For general purposes, this is any institution which we know of as a bank or as a provider of banking services.

Credit Rating – This is the rating which an individual (or company) gets from the credit industry. This is obtained by the individual's credit history, the details of which are available from specialist organizations (Equifax and Experian are the two big operators in the U.K. www.equifax.co.uk and www.experian.co.uk).

Credit-Worthiness – This is the judgment of an organization which is assessing whether or not to take a particular individual on as a customer. An individual might be considered credit-worthy by one organization but not by another. Much depends on whether an organization is involved with high risk customers or not.

Overdraft – This is when a person has a minus figure in their account. It can be authorized (agreed to in advance or retrospect) or unauthorized (where the bank has not agreed to the overdraft either because the account holder represents too great a risk to lend to in this way or because the account holder has not asked for an overdraft facility).

Security for Loans – Where large loans are required the lending institution often needs to have a guarantee that the loan will be paid back. This takes the form of a large item of capital outlay (typically a house) which is owned or partly owned and the amount owned is at least equivalent to the loan required.

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