Biyani's Think Tank

Concept based notes

Banking Services Operations

(MBA IV Sem Paper M-406)

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SYLLABUS

M-406
BANKING SERVICES OPERATION

Course/Paper: 402 **Max. Marks: 70**
MBA Semester-IV **Time: 3 Hrs.**

Objective:

The objective of the course is to develop the skills required for understanding India's most challenging and important financial services sector. Banking services operation will enable the management student to have an insight to the banking sector and how it works.

Section-A

Indian financial system: the financial system-nature-evolution and structure-the functions of financial intermediaries – financial instruments – the role of financial system in economic development – the Indian financial system.

Deposit products: types of bank deposits, computation of interest on deposits, deposit schemes, composition of bank deposits. **Credit policy**: Need for credit policy, credit policy components of credit policy, credit policy pursued by the government, credit culture.

Retail banking: basics of retail banking, forms of retail banking and emerging issues. **Corporate banking**: The nature of corporate banking, developments in corporate banking, consortium finance, multiple banking managements, and loan syndication.

Rural banking and Micro finance: sources of rural finance, credit delivery mechanism in rural finance to co-operative, agricultural and rural development banks (CARDB)- regional rural banks (RRBS), service area approach (SAA)-National Bank for Agriculture and Rural Development (NABARD), microfinance.

Follow up and recovery: NPA's classification, securitization, SARFAESI Act etc.

Securitization: meaning of securitization, process of securitization.

Fee-based services: the fee-based services of banks, letter of credits, bank guarantees, subsidiary services, off balance sheet activities, bancassurance.

Introduction of banking operations: the changing nature of banking operations, importance of customer relationship management in banks – different types of products and services offered to customers – role of technology in banking operations – the need for Asset-Liability Management. **Introduction to electronic banking:** electronic banking: market assessment, e-banking: an introduction, internet: e-commerce, e-banking in India, internet banking strategies, risks in e-banking. : Payment and settlement systems, RTGS and clearing house:

Section-B

Case and Problems

Dean, Rajasthan Technical University, Kota/2008-2009/Prof. Surendra Kumar Vyas, Chairman BoS, Department of Management & Technology, Engineering College, Bikaner

Think Tank Material

on

Banking Services Operations

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1. Explain in brief evolution and growth of financial system/institutions in India

Ans. This growth of financial system/ institutions can be discussed in two parts i.e.-

I. **Post independence**-

1. **Nationalization** (Public ownership of financial institutions)
   - RBI was nationalized in 1948
   - SBI was nationalized in 1956
   - 14 commercial banks were nationalized in 1969 and 6 more banks in 1980
   - LIC was nationalized in 1956
   - GIC was nationalized in 1972
2. **Establishment of development banks**-
   - NABARD in 1982 for agriculture and rural development
   - National Housing Bank (NHB) in 1986 for housing development.
   - Export Import Bank (EXIM) in 1982 for promoting international trade.
   - Many national level organizations for industries such as IFCI, IDBI, IRBI, ICICI & state level institutions like SFC, SIDC etc.
3. **Credit rating agencies for the benefit of investors**.
4. **Legal reforms for protection of investors**.
   - Indian companies Act 1956
   - Securities Contract Regulation Act 1956
   - MRTP Act 1972
   - FERA Act 1973
5. **Regulatory Bodies**
   - SEBI in 1988
   - IRDA in 1999
   - RBI in 1948 (established under RBI Act 1934, started working in 1935 and nationalized in 1948
6. **Participation of financial institutions in corporate management started to**
   - Control on erring management
   - Loan to corporate on the basis of nominees of financing institutions in the board of management.

II. **Post Nineties**-

1. Privatization of financial institutions
   - Organizations like IFCI, IDBI started take private equity
   - Many private sector banks emerged under guidelines issued by RBI
   - Many private sector insurance companies emerged-some of them in collaboration with foreign insurance companies.
   - Many private mutual fund companies came it to picture
2. **Protection of Investors**-
   - SEBI was made statutory body in 1992 to project interest of investors
   - IRDA in 1999 came up to protect the interest of policy holder. More private insurance companies came in both life and not life insurance as per guidelines of IRDA
3. **Liberalization**
   - In banking sector as more private sector banks came up.
   - In insurance sector more insurance companies both in life and non life came up
   - Economic liberalization policy started
   - Many tax reforms came up
   - Disinvestment in public sector undertakings
   - Legal reforms by way of changes/amendments in Indian companies Act
   - Globalisation

2. Explain in brief Indian Financial System & its key components.

Ans. Financial system refers to the system of borrowings and lending of funds or demand and supply of funds of all individuals, institutions, companies and of the government. Indian Financial System includes many institutions and the mechanism that effect the generation of savings, mobilization of savings and distribution of savings amongst all those who demand these funds for investment purpose.

Indian Financial System thus covers/consists of the following:

1. Financial market
2. Financial institutions and financial intermediaries
3. Financial assets/Financial instruments.

The financial market can be classified or sub divided into:

(i) Money Market
(ii) Capital Market
(iii) Government Security Market

Financial Institutions/intermediaries can be sub divided into following:

(i) Regulatory Institutions
(ii) Banking intermediaries
(iii) Non-banking intermediaries

Financial assets/instruments can also be divided into following:

(i) Primary
(ii) Secondary

Detailed explanations of Financial Assets/Instruments and Financial Intermediaries have been explained separately in this hand book.

3. **Explain in brief financial instruments and their main kinds.**

Ans. Financial Asset/Instrument is a liability of issuer towards holder. It is a claim against a person/institution for payment at future date and a periodic payment in the form of interest or dividend. A financial instrument helps the financial market and the financial intermediaries to perform the important role of channelizing funds from lenders to borrowers. They differ in terms of marketability, liquidity, types of options, return, risk and transaction cost.

Examples of Financial Instrument are:

- Currency notes issued by RBI, Govt. of India.
- Shares
- Mutual Funds units
- Debt Instruments such as-
  - Bonds
  - Debentures
- Deposits
- Insurance policies issued by Insurance companies

Kinds of Financial Instruments-

1. **On the basis of marketability**-
   Marketable such as shares, debentures, CD, CP, Commercial Bills Non-marketable such as Bank deposits, insurance policies.
2. On the basis of nature
   Cash securities- Such as currency notes
   Debt Securities- Such as shares, debentures
3. **Types of instrument/asset**-
   Physical – Created not for earning profit e.g. residential house
   Financial- Created for income generation e.g. shares, debentures.
4. Direct and Indirect also known as primary & secondary
   Primary/direct- e.g. shares, debentures
   Secondary/Indirect- e.g. mutual fund, insurance policies
5. **Capital Market & Money Market instruments**-
   Money Market- e.g. Treasury bill, CD
   Capital Market- e.g. Shares, debentures, bonds Govt. securities

4. What do you understand by financial intermediaries?

Ans. Financial intermediaries are institutions that mediate between ultimate lenders and ultimate borrowers or between those who have surplus money and those who wish to use the money to finance their deficit budgets. The best examples of such financial intermediaries are:

- Banks
- Insurance Companies
- Provident Fund
- Unit Trust of India etc.

The key function of these FI's is to collect surplus/savings and lend them to deficit spenders. Banks collect savings from public at large; invest these savings in to loans and advances and investments. Their main source of earning is the difference in borrowing rate and lending rate. They also earn money on various services provided to customers. Same is the case with Insurance Companies as they also collect savings though selling insurance policies.

Advantages to Lenders:

(i) **Low risk** – Risk of capital loss or interest loss to lender is minimum

(ii) **Greater liquidity –** The FI's offer greater liquidity and lender can convert investment in cash any time.

(iii) **Convenience**

(iv) **Other Services**

Advantages to Borrowers

(i) Demand of funds can be met as FI's have big pool of funds.

(ii) Certainty of availability of funds

(iii) Rate of interest is reasonable.

(iv) At times, small borrowers get preferential treatment.

5. **Explain in brief role of Indian Financial System in economic development.**

Ans. Economic development means development of all sectors of economy such as-

- Agriculture
- Industry
- Infrastructure
- Service sector

A well developed financial system helps in the development of all core sectors of economy by way of making available required funds for growth and development. The role of financial system can be discussed in following broad heads.

I. **<u>Economic angle of development</u>**
  - Financial system leads to more saving
  - More savings leads to more capital formation
  - Availability of more money for infrastructural development
  - Increase in production of goods & services
  - More exports after meeting local needs
  - Favourable balance of payment
  - Increase in image in world

II. **<u>Social angle of development</u>**
  - Increase in national income & per capita income further leads to:
  - Increase in per capita consumption
  - Rise in standard of living
  - Increase in expenditure on
    - Improving skills
    - Technological development
    - Health care
    - Education, recreation
    - Increase in life expectancy.
    - Widening mental horizons of people
    - Overall development of civic society creating civilized citizens

III. Transformation of economy after economic/social development.
  - From developed to developing & developed economy
  - From agrarian to industrialized or highly industrially developed economy
  - From rural dominated to urbanized economy

- From low saver to high saver economy.

IV. **Innovative & promotional schemes of financial institutions**- Operating in financial system.

- Innovative product and schemes of financial institutions such as lead bank scheme, priority sector lending, branches in rural areas, project preparation and project loans, innovative financial instrument suiting to different categories of clients/investors.
- Promotional activities such as project guidance, consultancy, education & training through institutions, helping govt. in formulation of policies etc.
- Financial literacy by RBI, SEBI, IRDA.

6. **Write in brief about deposit products and deposit schemes of banks in India.**

Ans. One of the key activities performed by banks is accepting deposit from public.

Important features of bank deposit are-

- Bank deposits are safe as-
  - Banks are under control of RBI
  - Bank deposits are covered under DICGC
- Highly liquid-even fixed deposits can be taken back on demand.
- Loans can be raised against bank deposits
- Interest rate differ from deposits to deposit
- Interest rate are subject to regulation by RBI

Deposit accounts with bank can be opened by different categories of customers such as-

- Individual account
- Joint account
- Partnership account
- Sole proprietor
- Company
- Govt./Corporate/Society/Trusts/Trade Unions Deposit schemes can be broadly classified as-

I. **Deposit accounts of Indian residents which include**.
  - **Saving deposits** to motivate and attract savings from public. Interest on saving is now 4% on daily balance.
  - **Current amount** which generally opened by businessman and banks do not allow any interest on this deposit.
  - **Fixed Deposit**- Deposit for a fixed period. Interest depends upon period.
  - **Recurring Deposit**- Depositing small amount every month maturing after fixed period say 5 years.
  - **Special deposit schemes of banks**
    - For senior citizens
    - For specified period say 555 days, 333 days, 444 days
    - Tax saving schemes e.g. fixed deposits for 5 years.

II. <u>Bank Deposits for Non-Resident-Indians (NRI's)</u>

(i) **<u>Non Resident Ordinary (NRO</u>** – Account to be open by NRI taking employment in a foreign country. Amount credited is not repatriable and subject to tax deduction at source and covered under General/special regulation by RBI.

(ii) **<u>Non-Resident External (NRE)</u>**- Accounts for person employed in foreign countries in firms owned by NRI's at least 60%. Deposits are accepted in foreign currency and freely repatriable, interest is exempted from tax.

(iii) **<u>Foreign Currency Non-Resident</u>** (FCNR) - Accounts such account are like NRE account but they are maintained in designated foreign currency at approved dealer. These currencies are US Dollar, Pond Sterling, Euro and Japanese Yen. Accounts are in the form of term deposits only.

(iv) **<u>Resident Foreign Currency (RFC) Account</u>**- Can be opened by a NRI who was in a foreign country for at least a year. Account may be in the form of current, saving, term deposit. No loan against & deposit balance outstanding can be transferred to NRE/FCNR accounts.

(v) **<u>Escrow Account</u>**- Account opened with the approval of RBI for adjustment of value of goods imported or exported. Account is opened in US Dollar in the name of overseas organization, no overdraft or loan is permitted.

(vi) **<u>Other accounts such as</u>**-

a. Foreign currency accounts of Airline Shipping companies.
b. Foreign currency accounts of overseas buyers.
c. Foreign currency accounts of foreign Embassies/Missions/Diplomats.

III. **<u>Deposits order National Saving Schemes</u>**-

After passing Government Savings Banks Act 1973, Post Office saving bank of India came in to existence. Governments saving banks were merged with Post Office Saving Bank (POSB). Different deposit schemes are-

- **<u>National Small Saving Fund</u>**- All deposits are credited to NSSF-withdrawals are permitted-amount in credit is invested in government securities.

- **National Saving Certificates (NSC's)** - Certificates are issued by post offices maturing after 5 years with tax benefit. Loan can be taken from banks against pledging these NSC's
- **Post Office Monthly Income Account**- Can be opened with a minimum of Rs.1000 and maximum of Rs. 3 lakh for single and 6 lakhs for Joint Account. Depositor gets monthly interest.
- **Public Provident Fund Account**- Another saving plan with minimum of Rs.500 and maximum of Rs. 70,000 per month. Deposits qualify for deduction of income tax under section 80-C of Income Tax Act.

7. What do you understand by credit policy? Explain its key objectives.

Ans. Credit Policy is a part and parcel of economic policy. It consists of all those measures through which Central Bank of the country i.e. BRI controls the supply of money to attain general economic objectives such as:

- Price stability
- Exchange rate stability
- Full employment
- Economic development

In India, credit policies are announced by RBI and following are key objectives of Credit Policy.

- To encourage savings and mobilize savings for capital formation and development.
- To encourage investment and create environment for investments in planned programmes.
- Supply of adequate credit to meet increasing demand of activities so that overall economic development is encouraged.
- To control inflationary pressure and maintain price stability.
- To encourage economic development without financial hindrance.

The RBI formulates and implements the credit policy and monitors it through various tools and techniques. These are general quantitative techniques and qualitative selective techniques.

Quantitative Techniques used are:

- Bank rate
- Open Market Operations
- Change in CRR/SLR

Qualitative methods of Credit Control are:

- Rationing of credit
- Changes in Margin requirements
- Regulation of consumer credit
- Direct action
- Moral suasion

8. Write a brief note in "Credit Culture".

Ans. Credit culture is the unique combination of policies practices, experiences and management attitude that defines the lending environment and determines the lending behaviour acceptable to the bank. Broadly, credit culture is the system of behavior belief, philosophy, thought, style and experience relating to management of credit function. Credit culture is made of principles that need to be communicated. The role of credit culture is to create a risk management climate that will foster good banking.

9. What do you understand by term Retail Banking?

Ans. Retail banking is typical mass market banking where individual customers use local branches of commercial bank. Retail banking refers to banking in which banking institutions execute transactions directly with consumers rather than corporations or other banks. Services offered include saving bank account, current account, fixed deposit/term deposit account, recurring deposit account etc. Transactions in term of loans like housing loan personal loans, education loans, gold loans, vehicle loans, agriculture loans, Mortgage loan etc. Similarly products like debit cards, credit cards, insurance products, pension plans etc.

Retail banking is banking service that focuses towards individual consumers and consumer markets. Retail banking is a high volume business with many service providers compiling for market share. The difference between retail and wholesale banking is essentially one of size. Retail banking basically deal with a large number of small value transactions where wholesale banking deals with smaller number of large value transactions.

Retail banking provide an ideal combination of higher margin business as well as fair degree of risk diversification and helps in better customer relationship and attracting new customers.

10. Explain in brief corporate banking. How it differs from retail banking?

Ans. Corporate banking is often used to refer wide range of financial services that are provided by financial institutions to various corporations, big business houses as well as government institutes. Corporate banking focuses on corporate style entities and high value transactions as against retail banking where focus is on individual customers.

In corporate banking, nature of banking products offered to corporate customers also differs. Salary account product is one such product offered where salary of all employees of big organization is credited to the account of all employees by debiting the account of organization. Banks also waive minimum balance criterions in these salary accounts and banks gain much on idle funds in these accounts. Such facility also helps the bank in selling retail products like credit cards to all employees.

In corporate banking, banks are maintaining good relationship with corporate/big business houses and such relationship helps in selling asset products by banks such as project finance for long term projects, involving significant capital investments, trade finance for meeting import export requirements, working capital loans to meet the liquidity requirement of ongoing projects etc. Non fund based products like letters of credit and guarantee etc can also be sold to such customers under corporate finance.

Difference between Retail and Corporate Banking

S. No.	Point of difference	Retail Banking	Corporate Banking
1.	Per customer business	Low	High
2.	Interest rates	Higher	Comparatively lower
3.	Chances of NPA	Low	High
4.	Relationship with customers	Not that important	Very important
5.	Publicity requirement	Required	Not very much required
6.	Pricing of products	Not effected much by change in Govt. policies	Immediate effect on changes of Govt. policies

11. Write a brief note on "Consortium Finance".

Ans. In Consortium financing several banks finance a single borrower with common appraisal, common documentation, joint supervision, and follow up exercise. When credit requirement of a unit are large, two or more banks/financial institutions join together and provide the required credit facility. In the big projects/institutions like IDBI, IFCI and ICICI operate a system of consortium finance through a common project appraisal. One of the financing institutions of the consortium act as a lead institution. The lead institution processes the loan application and gets the consent of other participating financing institutions.

The consortium finance enables the participating financial institutions to share the risk of lending, to share the expertise and experience. Normally, the financial institution or bank that sanctions maximum share of loan will take up the role of lead institution/lead bank.

12. **Write a brief note on loan syndication.**

Ans. Loan syndication is almost similar to consortium finance. Loan syndication is an arrangement between one or more lending institutions to provide a borrower a credit facility using common loan documentation. The syndication process is initiated by a borrower who appoints a leader through granting him mandate to act as the Arranger of Mandated lead Arranger on the deal. The arranger is responsible in advising the borrower as to the type of facilities it requires; and then negotiating broad terms of those facilities.

This term is generally used in international trade in which following type of banks are involved:

1. **Managing bank**- Appointed by borrower to arrange credit-borrower pay fee as percentage of loan.
2. **Lead bank**- Bank which provides major portion of loan.
3. **Agent bank**- Bank appointed by borrower to look after his interest after loan agreement is signed. This bank takes over from managing bank.
4. **Participating banks**- Banks actually providing loans-
   (i) Wholesale large banks providing major loans
   (ii) Retail sector banks providing small loans

13. Explain in brief Agencies for Rural Credit.

Ans. The organized institutional frame work available for disbursement of rural credit consists of the following:

1. Commercial banks
2. Regional Rural Banks
3. Cooperative Credit Structure

We have large network of nationalized commercial banks and their branches which are playing a crucial role in providing rural credit. Particularly after nationalization their role in meeting rural credit needs has become significant. They have been assigned targets for advancing agricultural and rural credit by Govt. of India.

The Regional Rural Banks CRRBD entered in the field of rural credit after passing of RRB Act in 1974. These RRB's were specifically created to supplement the efforts of cooperatives which performing this aspect of disbursing rural credit.

The cooperative credit structure is in the field of agricultural credit since last more than 100 years. In short term credit, structure consists of state cooperative banks at state level, District Central Cooperative Banks at district level and primary agricultural credit cooperatives at primary/village level. Similarly, for long term credit which is also known as Investment credit, there are State cooperative Agricultural & Rural Development Banks at State level and Primary Cooperative Agricultural and Rural Development Banks at district, Taluka level to disburse rural credit for long term period. The primary urban cooperative banks have also been authorized to disburse rural credit by RBI.

At the national level, NABARD is looking after this work and providing money to all three above agencies by way of refinance facilities.

In the unorganized sector, there are other agencies and important amongst them is money lender who is providing rural credit at a comparatively higher rate of interest.

14. Write in brief origin and function of RRB's.

Ans. Under the 20 P0int Economic Programme during emergency, one of the point was as follows:

"Provision of cheap credit for Marginal farmers, landless laborers, artisans in rural areas & liquidation of rural indebtedness in stages "

In order to implement this programme, Govt. of India came up with an idea to set up RRB's and for which RRB Act was passed in 1974. These RRB's were started in 1975to supplement the efforts of rural credit co-operatives in the rural areas.

The broad objectives with which RRB's came into being were as follows:

- To develop rural economy by providing financial assistance to :
- Agriculture
- Trade, commerce, industry and other productive activities.
- To provide credit and other facilities particular to -
  - Small & Marginal farmers
  - Agricultural laborers
  - Artisans and small entrepreneurs.

These RRB's are joint ventures of Central Government, State Govt. and sponsored bank with a share capital contribution of 50%, 15% and 35% respectively. A RRB was set up with an initial authorized capital of 1 crore to be contributed by these three agencies.

These RRB's are expected to prepare production plan in its area village-wise and block wise. They are permitted to attract deposits @ 1/2% more than the rates of commercial banks and their lending rates were kept at par with rates of village cooperative societies. The sponsored bank used to provide managerial and financial assistance to these banks.

The NABARD at the national level provides finance to these banks and monitors their working.

15. Explain in brief how CARDB's function?

Ans. CARDB's are part of cooperative credit structure. A Chart showing cooperative Credit Structure is enclosed. They are engaged in providing investment credit (Long term credit) for agricultural and rural development. These banks were earlier known as Land Mortgage Banks but their name was subsequently changed as Agricultural and Rural Development Banks as their main purpose of providing long term credit is agriculture and rural development.

Generally structure of such banks is federal i.e. State CARD Bank at State level with primary CARD BANK at District, block and primary level. However, in some states their structure is unitary i.e. State CARDB with its branches at primary level. However, in some small states, State Cooperative Bank is also working as CARD Bank by disbursing long term credit also.

These banks provide long term loans (5 to 20 years) on mortgage of agricultural land by the farmers e.g. loan for purchase of Tractor, installation of tube wells and various other similar purposes of agricultural and rural development. Generally loan amount is 50% of value of land owned by farmer. For purchase of farm machinery/equipment, bank is making direct payment to supplier on behalf of farmer.

NABARD is refinancing the loan amount to State CARD BANKS. These SCARD BANK are raising funds through share capital, fixed deposits (as a special case) debentures and interim finance from State Bank of India. The main source is debentures which are issued on the basis of effective mortgage deeds available. NABARD is also undertaking voluntary inspection of these banks.

16. Explain in brief Service Area Approach.

Ans. This SAA is being implemented from 1989 and is applicable in rural and semi-urban areas. Under the scheme, each bank branch i.e. branch of a co-op bank, RRB or a Commercial bank is allotted a specific service area consisting of about 15-20 villages. The area allotted is known as Command area. Each bank branch is expected to conduct detailed survey of village including economic potential available in the village and based on this survey, village credit plans are prepared on annual basis. This credit plans are then compiled and converted into block credit plans and finally, block credit plans are converted into District credit plans.

In these plans, not only credit requirements of existing facilities but also requirements for starting new activities are planned. The purpose of whole exercise is to met the credit needs in full by banking institutions so that development of command area could be ensured.

For monitoring, Block Level bankers Committee (BLBC) and District Level Bankers Committee (DLBC) have been visualized under the scheme and formats as well time schedule for preparing & compiling plans have been prescribed.

District Development Manager (DDM) NABARD as well as District Administration are also involved in overall monitoring and implementation of the scheme.

17. Explain in brief NABARD and key tasks performed by it.

Ans. NABARD was set up as a "Development Bank" on 12.7.1982 and functions of Rural Credit Dept. of RBI were transferred to this bank. It came into being with a mandate to promote integrated and sustainable rural development and secure prosperity of rural areas. It is providing investment credit (long term credit) and production credit to promote and develop agriculture, small scale industries, cottage and village industries, handicraft and other rural crafts and for creating/improving rural infrastructure for overall rural development.

Important tasks entrusted to NABARD in rural areas are:

1. Providing refinance to lending institutions in rural areas like :
   - Commercial Banks
   - Regional rural banks
   - Cooperative banks (State cooperative banks for District Co-op. Banks & Primary Agriculture Credit Co-opts, Co-op. Agriculture & Rural Development Bank).
   - Other financial institutions approved by RBI.
2. Promoting Institution building (e.g. Farmers' clubs, Farm Hatts, Rural Marts etc.)
3. Coordinating operations of rural credit institutions.
4. Evaluating, monitoring and inspecting rural credit institutions.
5. Acting as regulator for cooperative banks and regional rural banks.
6. Maintaining liaising with Central Govt, State Govt, and National Level Organizations for policy formulation relating to rural development.

NABARD is also looking after HRD needs of rural financing institutions for which it runs Bankers' Institute of Rural Development (BIRD) at Lucknow. It raises funds from Govt. of India, RBI, issuing development bonds/debentures and RIDF deposits.

Under this act, there a provision of appeal against the order of DRT within 45 days. The RBI has to provide a key role as regular over securitization and Reconstruction Company.

18. Explain in brief the term "Micro-Finances" and its role in upliftment of poor.

Ans. Micro-Finance has been defined by RBI "as provision of thrift and credit and other financial services of very small amount to the poor in rural, semi urban and urban areas to improve their income and living standard".

Micro-credit institutions are those which are engaged in providing credit and other facilities to these poor strata of the society. RBI has asked banks and financial institutions to formulate their own schemes, models, prescribe suitable criterions, choose suitable branches, credit norms and interest rates etc for this purpose. Accordingly, banks have to prepare micro-credit plans for blocks, districts and the whole state for this purpose and these plans are reviewed at State and National level.

The non-governmental organizations (NGOs), voluntary organization and self help groups are playing critical role in providing micro-finance facilities. Even NABARD is playing active role in supporting these organizations and even arranging financial assistance to them. Many states have also launched various schemes of micro-finance for increasing income of poorest of the poor in rural, semi urban and urban areas.

Micro-Finance products:

1. Micro credit
2. Micro savings
3. Micro insurance
4. Micro leasing
5. Micro Money Transfer

Participants in Micro finance are-

- Financial institutions
- Donors
- Private equity
- Micro-finance institutions
- Self help groups
- Non-Government organizations (NGO's)

Famous name in Micro-finance is Mohammed Yunus of Bangladesh who was awarded Noble Prize in the year 2006 for his pioneering work in the field in Grameen Bank, Bangladesh.

In India SHG's are playing key role in the field of Micro-finance with key objective like-

- To create habit of savings
- To secure financial technical and moral strength
- To avail loan from financial institutions
- To gain economic prosperity through loan/credit
- To save them from exploitation by money lenders.

Millennium Development Goals of Micro-finance are-

- Eradiate extreme powerty and hunger
- Universal primary education
- Women empowerment
- Reduce child mortality
- Control HIV/AIDS, Malaria etc.

19. What do you understand by NPA's? What are their causes and how they can be controlled?

Ans. A bank's balance sheet will have performing as well as non performing assets. Performing asset means an asset on which interest income is received from the borrower as and when it is due and the principal is also repaid on due date as per the repayment schedule agreed between banker and borrower. Hence an asset which is not a performing asset is treated as non performing asset. It mean that an asset on which interest or principal is not received when due. The RBI took a decision that if this amount is not recovered within 90 days from the date it becomes due, it would be treated as NPA. Before 31.3.2004 this period was 180 days. Now banks can't show the interest income on such amount as receivable income and thus cannot increase their profit by crediting the same in Profit & Loss A/c.

Hence in simple words, an asset which ceases to earn income is treated as NPA. However, there are exceptions in this regard such as :

1. Loans guaranteed by Central & State Governments.
2. Loans against FD/NSC/IVP/KVP if adequate margin has been maintained.
3. Loans which have been rescheduled for the purpose of repayment.

<u>**Gross & Net NPA –**</u>

Gross - Total amount of NPA before making provision for NPA

Net - Total amount of NPA Less provision made for NPA

Hence after making provisions for NPA, many banks have 0% net NPA's in relation to total loans and advances.

<u>**Classification NPA's & Provisioning Norms**</u>

(1) **Sub-Standard assets**: An asset which remain NPA for not exceeding 12 months. General provision of 10% is required to be made

(2) **Doubtful Assts:** An asset which remained in sub standard category for 12 months. Provision is required to be made according to the period. Further 100% provision on unsecured portion of asset.

(3) **Loss Assets:** Assets which are not recoverable, provision @ 100% is to be provided till written off.

Further general provision is required @ .25% on standard asset. These are assets which carry normal risk and are not NPA. This classification as well as provisioning is required to be made as per latest guidelines issued by RBI in this regard.

Reasons for rise in NPA's		
S.No.	**Internal Factors**	**External Factors**
1.	Deffective lending policies	Ineffective recovery tribunals
2.	Poor credit appraisal	Willful default
3.	Improper SWOT analysis	Natural calamities
4.	Lack of information base about loan becoming NPA	Sickness due to external factors
5.	Absence of regular contact/visits to the borrowers	Changes in Government policies

Measures to Overcome NPA's		
S. No.	**Preventive Measures**	**Curative Measures**
1	Proper credit assessment/appraisal	Making debt recovery tribunals more effective
2.	Organisational restructuring for ensuring timely and proper follow up with borrowers	Organizing Lok Adalats for speedy disposal of cases
3.	Quick action against border line cases	Use of SARFAESI ACT

Government initiative to overcome problem of NPA's

1. **Sick Industrial Companies Act 1985**
2. **Board of Industrial & Financial Reconstruction (BIFR) 1987**
3. **Recovery of Debts due to Banks & Financial Institutions (RDDBFI) Act 1993**
4. **Corporate Debt Restructuring**- To Preserve viable corporates
5. **SARFAESI Act 200**

20. Explain in brief key features and objects of SARFAESI Act 2002.

Ans. This SARFAESI Act 2002 has created a new legal framework and new procedure for recovery of dues of banks and financial institutions. The rights of banks and financial institution over securities both movable and immovable for realizing the loan advanced were limited and less effective before passing of this SARFAESI Act. Now, under this Act, banks and financial institutions got ample powers to enforce such security for realization of money due particularly loans in NPA category without the intervention of courts. This Act presupposed a simple thing that there is an obligation on the part of borrower to repay loans and if they are unable to repay, then the securities for loans are liable to be sold for recovery of loans.

This Act is effective from 21.6.2002 and has retrospective application i.e. it applies to loans and securities created prior this Act coming into operation. This act is applicable on all banking companies, nationalized banks, State Bank of India and its subsidiaries and cooperative banks. However, RRBs are not covered under this Act.

This Act has permitted "Securitization" which means acquiring financial assets of a bank or financial institutions by a securitization or Reconstruction company. This company to be registered under companies Act 1956 can convert the acquired financial asset in to marketable securities and place them in market for trading. This securitization & reconstruction company also needs registration with RBI. This securitization is a process of converting loans & receivable of banks into marketable securities.

For recovering loans under this Act, a bank or financial institutions has to give a 60 days' notice to the borrower indicating the details of amount to be recovered. If borrower raises some issues, the bank has to clarify these issues. If borrower is not satisfied, he can go into appeal in Debt Recovery Tribunal by depositing 50% amount. If borrower fails to repay amount within this notice period, the bank, financial institution (Secured creditor) can take the property into possession, sell the property and recover the amount. If amount recovered is less, he can move against guarantors. If amount recovered is more, the excess amount can be refunded to the borrower.

21. What do you understand by Securitization? Explain its process and advantages.

Ans. Securitization means acquisition of financial assets by a securitization or reconstruction company. This process of acquisition (securitization) is resorted to reduce large non performing asset (NPA) i.e. loans or portfolio of loans from a bank or financial institution by a securitization and reconstruction company (SCRC) on mutually agreed terms and conditions. This is a process where non-liquidated financial assets are converted in to Marketable securities i.e. security receipts that can be sold to investors. It is also process of converting receivables and other assets into securities i.e. security receipts that can be placed in market for trading.

On acquisition of financial assets, the SCRC becomes the owner of the financial assets and steps in the shoes o f lender bank or financial institution. The RBI is the regulatory authority for a SCRC. The SCRC is a company registered under the companies Act 1956 for the purpose of securitization and it also needs registration from RBI as per SARFAESI ACT 2002.

Securitization refers to process of liquidating illiquid assets like loans receivables by issuing marketable securities against them.

Various stage involved are-

1. **Identification**- of assets to be securitized
2. **Transfer Process**:- in favour of Special Purpose Vehicle (SPV) or trust or ARC
3. **Issue Process**: Issuing securities to investors which are known as pay through certificates or pass through certificates
4. **Redemption process**: Repayment of principal and interest is made out of collection of securitized assets.

Advantages of Securitization:

- Additional source of funds to originator
- Greater profitability
- Helps originator to have easy access to security market
- Avoids idle capital

Securities issued are better than traditional securities as they are backed by securitized assets.

22. Explain in brief Bank Guarantee.

Ans. A guarantee is assurance by a bank on behalf of his customer to a third person/party for payment of certain sum to him (third person) in case his customer fails to pay or fail to fulfill any contractual or legal obligations towards such third person. Here, primary duty to pay is that of customer. However, bank comes in picture when customer fails to fulfill his commitments.

TYPES OF GUARANTEES

1. **Financial Guarantee**: A guarantee given by bank in lieu of depositing cash security or earnest money by the customer. This is generally given in the case of contractors.

2. **Performance guarantee**: Where a person has agreed to do certain things on or before a particular date. In case of default to carry out promise by stipulated date, bank guarantee is asked for.

3. **Deferred payment guarantees**: Where a person is required to make payment in installments spread over a period. For covering such default in paying installment, a bank guarantee is asked for which is known as deferred payment guarantee.

4. **Statutory Guarantee**: Guarantee issued by banks in favour of courts and other statutory authorities like Income Tax, Sales Tax, P.F, Customs and Central Excise Dept. etc.

For all the guarantees mentioned above, bank is charging fee for this purpose.

Two things are important i.e. Amount of guarantee and period of Guarantee.

Adequate judicial decisions are available where it has been held that banks duty to honour guarantee is primary/obligatory.

23. Explain Letter of Credit and its whole process.

Ans. A letter of credit (LC) is a type of guarantee given by a bank on behalf of its customer that the bank would make payment of goods and services to the supplier on presentation of documents, as required as per terms of the contract and LC. This term LC is often used in international trade when buyer and seller are far away from each other having different legal system and each unaware of others financial position. In such case, both parties deal through their banks and the devise used by banks is called LC or BCC.

Parties to LC are :

i) Applicant/Buyer/Importer/Opener
ii) Issuing bank
iii) Beneficiary/Exporter/Seller
iv) Advising Bank/Notifying Bank – Bank in exporter's country through which LC is advised to the seller.
v) Negotiating bank/nominated bank/paying bank – Bank in exporters country which makes payment on bills drawn by seller.
vi) Reimbursing bank – bank appointed by issuing bank to reimburse payment to negotiating bank.

Procedure of L.C.

Purchaser makes an application to his bank for opening a L.C in favour of seller of other country. The bank after verifying the credit worthiness of applicant opens a LC. This L.C is then forwarded to the sellers bank in other country. The sellers bank after confirming the authenticity of LC, forwards the same to seller. The seller confirms the authenticity of LC, ships the machinery to the purchaser. Seller collects the bills of lading handed over by shipping company alongwith other documents under L.C; present these documents to his bank for obtaining the payment. After verifying bills documents, bank makes payment to seller. These documents are then sent to the purchaser bank under intimation to purchaser. The purchaser accepts the bill, collects the documents and makes payment. The purchaser goes to the shipping company, produces the documents and takes delivery. The purchaser's bank then forwards the payment to seller's bank.

Documents under L.C

1. Bill of Exchange
2. Invoice

3. Transport documents e.g. bills of lading in case of a shipping company, airline bill in case of air transport, post parcel bill if sent by post
4. Insurance documents signed by insurance company or his agent.
5. Other documents as per terms of L.C e.g. certificate of weight, quality etc.

Benefits of L/C

To Purchaser:

- No advance payment is required.
- Not worried as payment only after getting documents.
- Not worried about quality as certificate to that effect is there in documents.
- He is sure of payment as banks are involved.
- There is no delay in payment.
- Not worried about import regulations of buyer's country.

To Seller:

- He is sure of payment as banks are involved.
- There is no delay in payment.
- Not worried about import regulations of buyer's country.
- Not worried about fluctuations in currency rates as he gets payment in his currency.

The banker's duty is primary for making payment as has been decided in many cases by various high courts and hence risk in L.C is minimum.

Types of Letters of Credit (LC)

1. **Revocable**: One which allows cancellation or amendment of credit without prior notice to beneficiary however, LC should clearly state whether it permits revocation.
2. **Irrevocable**: All LC's are irrevocable unless stated in LC. Irrevocable LC cannot be cancelled/amended without consent of beneficiary.
3. **Confirmed/unconfirmed LC**: When on the request of issuing banker, bank in buyer's country confirms the credit, it is called confirmed credit and when not confirmed by buyer's bank, it is called unconfirmed LC. This confirmation is extra guarantee to the seller.
4. **Revolving LC**: Such LC's are opened to cover a series of transactions with the same buyer during a specified period.

24. What do you understand by off-balance sheet activities of banks?

Ans. Off. Balance Sheet items are essentially claims or contracts that legally bind a bank to lend or provide funds should the contingency be realized such as commitments to lend or to provide back up capital. Common items are-

i. **Commercial or standby letter of credit**- it is like bank guarantee and bank is required to pay and if applicant fails to perform/make payment as per contract.

ii. **Loan commitments**- Banks often provide/sanction loans to customer on the condition that bank would provide loan on some future date if customer needs funds. This is also known as open line of credit. If loan is not borrowed at future date, banks are generally taking commitment charges for this from the customers.

iii. **Investment related commitments**- These are commitments to undertake interest rate risk through forward, future and option contracts and interest rate swap agreements. These are contracts to buy or sell financial instruments at on agreed price. Regulations allow banks to engage in these transactions for hedging purpose only.

iv. **Commitment to buy or sell foreign exchange**: This major contingent liability for many money-centre banks. Banks participates in foreign exchange market to provide their customers variety of services. For a fee, bank will assume customer risk an unfavourable exchange rate movement

v. **Pending cases in Courts**- Contingent liability also there in respect of pending court cases against banks. For example-some retrenched employees have filed case in court for their reappointment. If bank looser the case, banks may be asked to pay salary/compensation etc. it bank wins, no liability is there on the part of bank.

25. Write a brief not on banc assurance.

Ans. Banc assurance means distribution of insurance product through the distribution channels of banks. It is also known as "All Finanz" and constitutes package of financial services that can fulfill both banking and insurance needs at the same time. It is a packaged service of banking and insurance offered to customer at one place, under one roof and at one time.

The motives behind 'banc assurance'

For a Bank are:

- product diversification
- generating additional income

For Insurance Company are:

- Increasing their market penetration
- Increasing premium turnover
- Reducing initial costs of selling
- Making use of wide network of banks for selling their products.

For a Customer:

- Product at a reduced price
- Product of high quality
- Product at a single point/doorstep.

Some challenges/Problems

1. The Rules of IRDA requires a mandatory4 weeks training for selling insurance products which a bank employee find it difficult to undergo.
2. Most of the bank branches particularly in rural areas are not fully computerized and there are problems when work of insurance is handled manually.
3. There is a cultural conflict between the products of banks and insurance. While the bank products are "demand" products and insurance products are "push" products. The selling of insurance products cause lot of pressure for the person selling/bank employee.
4. At times performance recognition becomes problem as to whom the commission on selling insurance product in a bank is to be given.

Inspite of these problems, insurance companies are collaborating with banks for selling their products through banks and generating additional income.

26. What do you understand by Customer Relations Management in Banks?

Ans. The Large scale branch expansion and competition between banks have forced banks to refine their products and services to attract more and more customers and build permanency in relationship with existing customers. Many banks have even started appointing customer Relations Executive for relationship banking and meting needs and aspirations of customers. Relationship Manager is an extended arm of bank performing the critical function of personalized service to a client for enhancing customer friendly image of the bank.

It is reasonable expectation of any customer that relationship banking should provide them preferred access to credit. It consolidates their deposit business at a particular bank

They believe that they can vastly enhance their credit prospects also. Liberalization and growth of competition have transformed banking into buyers market. In this atmosphere, relationship banking is an effective tool to provide maximum customer satisfaction through vastly augmented services.

Hence relationship banking has now become a integrated part of marketing strategy of banks. For building relationship- for longer period, many banks have stared keeping their Managers for a longer tenure where through relationship banking, banks growth in terms of deposits and credit portfolio is showing exemplary results. Through customer relationship banking, banks have the potential of raising overall profitability for the bank significantly besides establishing a good image for the bank branch in market for long.

Benefits of CRM to:

1. **Customers**: They feel empowered and have greater access to products and services. Offer of product can be timed with customer's requirements such as education loan etc.: With adequate knowledge about customers, personalized services can be arranged to customers.
2. **Employees**: Have more time to serve customers and are empowered with information to deliver high quality products & services to meet customers' expectations.
3. **Bank**: Optimum use of resources with greater loyalty and customer's satisfaction. Bank can retain existing customers and attract new customers due to better CRM. Bank Officers can better utilize opportunities for increasing business of banks and increase overall profitability.

27. Explain in brief different types of products and services provided by banks in India.

Ans. Various products offered by banks can be classified as retail banking product and corporate banking products

Retail Banking Products- can be further classified as-

1. **Liability products**- Such as SB, Current, Recurring Fixed Deposit Account and no-frill account
2. **Asset Products**- loan like Housing, Personal, Education, Gold loan, Mortgage loan, Vehicle loan, Agricultural loans etc.
3. **Credit & Debit Cards**-
4. **Investment Products**-Such as insurance plans, pension plans, mutual fund etc.

Corporate Banking Products-

1. **Liability Products**- Such as salary accounts of employees, current account, fixed deposit account, payment cards etc.
2. **Asset Products**-Such as trade finance in the form of cash credit (clear, pledge, hypothecation) short term loans, capital loans, letter of credit, guarantee, corporate finance, project finance etc

Various services provided by banks-

1. Trusteeship services- Such as safe deposit, locker facilities
2. Money transfer facilities like Demand Draft EFT, RTGS, etc.
3. ATM facilities (debit card)
4. Project Guidance through project preparation and project finance
5. De mat account facilities
6. On-line banking
7. Consultancy & advisory services such as portfolio management etc.
8. E-banking/E-Commerce
9. Tele Banking
10. Foreign exchange services by authorized banks.

28. Write in brief role of technology in banking operations.

Ans. In this highly competitive banking sector, entry of foreign banks in Indian and innovations taking place in the era of information technology it has become necessary for banks to make use electronic mode of transacting their business to ensure:

- Greater convenience to customer
- Avoid time taken in completing transaction
- Speedy completion of transaction
- Avoid distance problem in banking services

Hence, due to technology, banks are providing following services to customers:-

1. **Automatic Teller Machine (ATM)**- Also known as any time money has become very popular these days.
2. **Electronic Fund Transfer (EFT)**- Automatically transfers money from one account to another, from one entity to another.
3. **Tele Banking**- It is "round the clock" bank on phone services allowing customer
4. **De mat Account**- Introduced by SEBI to regulate and improve stock investing.
5. **On-Line Banking**- Availing various banking services through home personal computer.
6. **Point of Sale Terminal**- Is initiated by using a payment card at a retail location.
7. **Electronic Data Interchange**- Is an automatic system of business-to-business data exchange
8. **Clearing House Automatic Payment System (CHAPS)**- Are electronic messaging system in which all transactions are transmitted in code to help reduce the risk of fraud.
9. **Cyber Cash**- It offers a secured conduit to deliver payment between customers, merchants and bank.
10. **Shared Payment Network System (SPNS)** - Established at the initiative of Indian Bank association. Participating banks issue universal cards to the customers for transacting on this network.
11. **E-Cheques**- In it payer issues a digital cheque to the payer and entire transactions are done through internet.

29. Write brief not on the following –

i. E-banking

ii. E-commerce

Ans. **E-Banking**- Also known as electronic banking or internet banking, it means the conduct of banking electronically. Any user with personal computer (PC) and a browser can get connected to his banks website to perform any of the virtual banking functions. In true internet banking, any inquiry or transaction is processed online without reference to any branch or any time.

E-banking has following dimensions

- Customer to customer e-banking
- Banker to bank e-banking
- Electronic control banking
- Internet procurement

Use of e-banking in following services

- Bill payment services
- Fund transfer from one bank to another anywhere in India
- Credit Card customer can pay their credit cards bills online
- Re-charging of phone/mobile phones
- Investing through internet banking

There are lot of advantages of e-banking to customer, banks, traders/merchants, Government & nation, but if banks server is down, the system would not work.

E-Commerce- Electronic Commerce consists of buying and selling of products and services over electronic system such as internet or other computer network. A wide variety of commerce is conducted in this way such as-

- Spurring and drawing conclusions on electronic fund transfer
- Supply chain management
- Internet marketing
- Online transaction processing
- Electronic data inter change
- Inventory management system
- Automatic data collection systems

<u>Scope or forms of e-commerce</u>- May be between the following-

1. Business to Consumer (B2E)
2. Business to business (B2B)
3. Business to Employee (B2E)
4. Consumer to Business (C2B)
5. Consumer to Commerce (C2C)
6. Business to Government (B2G)

Use of e-commerce is made for

1. Information sharing
2. Ordering
3. Payment
4. Fulfillment, services & support

E-commerce is of great advantage to consumers, business houses by way of

- Lower time cycle
- Lower sales/marketing costs
- Better consumer services
- Coverage of more geographical area easily/quickly

30. What do you mean by Real time Gross System?

Ans. This RTGS is an important milestone in Indian banking system through which high value cheques (cheques of Rs.1 lakh and above) are settled and amount is credited in the customer's account on the same day. The settlement of account between two banks takes place through RBI. Each participant bank RTGS will be required to open a dedicated settlement account with RBI for putting through RTGS settlements. The system enables the participating banks to place instructions with Deposit Account Department (DAD) of RBI, Mumbai.

In this system, electronic message is sent to another banker through RBI, Mumbai and account is settled within 4 hours on the same day. Not only cheques of high value can be credited through this system but also money transfer transactions can also be completed through RTGS system. Even the foreign exchange transaction between Indian bank as well as a foreign bank can also be settled through this RTGS system.

The system works with no risk and is of great help to the customers as well as banks.

31. Explain in brief the process of clearing house.

Ans. It is a meeting place for the representatives of member banks at appointed hours on each working day to settle payments of cheques and other transfer orders on each other by their customers. It is an association of banks operating in a particular locality. These clearing houses are generally run by RBI where it has offices and by State Bank of India (SBI) and its subsidiaries elsewhere.

Each member bank has to maintain minimum balance; with the bank doing this clearing house work. This work process of clearing cheques and money transfer in two sittings. In the forenoon sitting, all banks meet and present cheques deposited by their customers which are drawn on other banks. In this sitting, each bank representative collects the cheques drawn on his bank and brought by representative of other banks. The concerned bank representatives carries cheques drawn on his bank and checks up the accounts of concerned customer and clear them. In the second/afternoon sitting, all representatives of banks again meet in clearing house and brings with them cheques cleared or cheques which cannot be cleared. Accounts of all banks maintained in the bank doing clear housing work are debited or credited and their accounts are settled. If a particular bank has some deficit in its accounts due to heavy debit, that bank is immediately asked to deposit more amounts in the account maintained by bank doing clearing house work.

Hence through clearing house, accounts of all member banks are settled and the cheques of customers are cleared.

32. Write a short note on Cash Reserve Ratio (CRR).

Ans. All scheduled banks are required to maintain CRR in relation to their time and demand liabilities (TDL) with Reserve Bank of India under section 42 of RBI Act, 1934. Under this Act, RBI is empowered to impose statutory cash reserve on banks anywhere between 3% and 15% of net TDL. Presently this CRR is 4.00%. This cash is partly held in the form of "cash on hand" and partly in the form of "Balance with RBI". The primary purpose of maintaining minimum CRR in the form of cash on hand &balance with RBI is to ensure liquidity and solvency of scheduled banks.

Unscheduled cooperative banks are required to maintain CRR in the form of cash in hand and cash in current accounts with notified banks.

Maintaining CRR below the rate prescribed would attract penalty for bank.

33. What do you understand by term Capital Adequacy Ratio/Capital to Risk Asset Ratio (CAR/CRAR)?

Ans. This CAR/CRAR is ratio of capital fund of a bank in relation to risk weighted assets. For this purpose capital fund consists of Tier I capital and Tier II Capital. This Tier I capital consists of items of core capital such as paid up capital, statutory reserves, disclosed free reserves capital reserve representing surplus arising out of sale proceeds of assets and undistributed profit less losses and intangible assets. The Tier II consists of undisclosed reserves, cumulative perpetual preference shares, revaluation reserve etc. The risk weights to each asset have been prescribed by RBI and often such risk weights are changed by RBI. All banks are informed about this change in risk weights through its circulars by RBI.

Presently, the rate of CAR/CRAR as prescribed by RBI is 9% and hence all banks are required to maintain a CAR @ 9%. This CAR is in addition to CRR/SLR required to be maintained by banks. This CAR represents adequacy of capital fund available with banks to bear the risk which is hidden in different types of assets held by a bank.

This present rate of CAR is likely to be raised in future by RBI to further strengthen the capital base of banks and their risk bearing capacity.

34. Write brief note on the following-

(i) Multiple banking arrangements
(ii) Unit banking
(iii) Universal banking

Ans. When credit arrangements of a borrower are met by more than one bank and each bank lends independently on his own terms and conditions regarding security, rate of interest margin etc. This financing is called **"Multiple Banking Arrangements"**. It is like consortium finance/arrangement. To ensure smooth and safe- finance, each bank have to freely exchange information about borrower. Its features are-

- Borrower approaches different banks for this total credit requirement.
- Each bank independently assess credit requirement.
- Documentation, monitoring is done independently by each bank.

To ensure that this system works without any incidence of fraud, RBI issued guidelines that banks while providing fresh advance should obtain declaration from borrower about loan borrowed from other banks, banks should regularly exchange information about conduct of account of borrower, add clause in agreement regarding exchange of information etc.

Difference between Multiple Banking Arrangement & Consortium Finance

S.No.	Multiple Banking Arrangements	Consortium Finance
1.	Each bank finance independently	Two or more banks forms a consortium for financing
2.	Each work independently	One bank giving major credit acts as a lead bank.
3.	Each bank independently conducts appraisal, documentation & monitoring	Common appraisal, documentation monitoring.

(ii) Unit System of Banking or Unit Banking:

Unit banking refers to a single bank which renders services and operates without any branch anywhere. This system is most common in USA but not common in India. However in urban co-operative banking sector, these are few banks which do not have any branch and work from a single office. However such banks have small business/turnover. Theory behind unit bank has been that each bank should be a local institution, locally financed and managed, drawing funds from local depositors and using its resources to develop local enterprises

(iii) Universal Banking:

Universal banking refers to those banks which offer a wide range of services of savings, loans, investment, insurance etc. Hence universal banking is a combination of commercial banking-investment banking and various other activities such as insurance etc. A universal banking is a one stop shop which deals with wide portfolio of financial products such as project financing, term lending, commercial banking, investment banking, retail operations, mutual funds, under writing of securities, insurance etc. key advantages of universal banking are-

- Greater economic efficiency
- Low cost
- Higher output
- Better services

Key Terms

1. **Agencies for Rural Credit:** Key agencies engaged in disbursement of rural /agricultural credit are cooperative banks, commercial banks, regional rural banks and micro finance institutions . In cooperatives sector one set of agencies are there for short & medium term and other for long term credit.

2. **Asset Liability Management (ALM):** ALM is a systematic process to maintain proper match in maturity timings of investments so that at no time there is risk of liquidity without adversely effecting profitability of a bank. Liabilities need to be deployed in the form of loans and investments in such a manner that adequate cash is always available to pay off the liabilities.

3. **Bank assurance:** Means distribution of insurance products through the distribution channel of banks It is packaged service of banking and insurance products offered to customers at one place under one roof and at one time.

4. **Bank Guarantee:** It is a assurance by a bank on behalf of his customer to a third party for payment of certain sum to him (third party) in case his customer fails to fulfill any contractual obligation towards such third person. Primary duty to pay is that of customer. However bank comes in picture when customer fails to fulfill his commitment.

5. **Bill of exchange:** Bill of exchange is an order drawn by the creditor on debtor instructing the later to pay a specified sum of money to the former or his nominee. Payment is usually made after fixed date usually 90 days with 3 days of Grace.

6. **Bill Discounting:** When holder of the bill does not wait for payment by debtor, goes to bank and discounts the bill, it is known as bill discounting . Bank charges some discount and pays the balance to the holder.

7. **Bonds:-** Bonds refer to debts instruments bearing interest on maturity. Organization may borrow funds that securities name bonds having a fixed

maturity period and pay a specified rate of interest (Coupon Rate) on the principal amount to the holders.

8. **Cash Reserve Ratio:** Each scheduled / commercial bank is required to maintain cash reserve under section 42 of RBI Act 1934 in respect of its total time and demand liabilities. Presently this CRR is 6%.
9. **Capital Adequacy Ratio (CAR) or Capital to risk asset ratio(CRAR):** Each bank is required to maintain capital fund in relation to its risk weighted assets as a measure to bear risk. Presently this CAR/CRAR is 9%.

10. **Capital Market:** Capital Market refers to institutional arrangements for facilitating borrowing and lending for long term securities having maturity period of above one year. Capital Market can be divided into primary market and secondary market.

11. **Clearing House:** Is an arrangement through which bank exchange cheques drawn on other banks for those drawn on it. This exchange is done at clearing house. Generally RBI or SBI acts as a clearing house for this purpose.

12. **Cooperative Agriculture & Rural Development Banks (CARDB'S):** CARDB'S are part of cooperative credit structure. They are engaged in providing investment credit(Long Term Credit).for agricultural and rural development . Earlier they were known as land mortgage banks. Their structure is generally federal where there is a state CARDB Bank at state level and Primary CARD Bank at district/taluka level.

13. **Corporate Banking:** Corporate Banking refers to wide range of financial services provided to various corporations, big business houses as well as Govt. institutions . It focuses on high value transactions a against retail banking where focus is on individual customers.

14. **Consortium Finance:** when credit required of a unit is large, two or more banks & financial institutions join together and provide the credit with common appraisal. Common documentation, joint supervision and follow up, it is known as consortium finance.

15. **Credit Policy:** Credit Policy is a part & parcel of economic policy. It consists of all those measures through which central bank of the country i.e. RBI controls, the supply of money to attain general economic objectives such as prices stability, exchange rate stability, full employment & economic development.

16. **Credit Culture:** Credit Culture is a unique combination of policies , practices, experiences, philosophy, thought and style relating to management of credit. Role of credit culture is to create risk management climate that would foster good banking.

17. **Credit Analysis:** Credit analysis distinguishes between "Good" customers that will pay and "Bad" customers that would default. It is done through five "C" s i.e. Character, Capacity , Capital, Collateral and conditions. Finally, credit analysis help in finding good borrowers.

18. **Customer Relationship Management (CRM) in banks:** CRM includes methodologies technology ,strategies & capabilities that help a bank to manage customer relationships. The general purpose is to better manage their customers through reliable systems, processes and procedures and attract new customers . Banks have starting recruiting customer Relation Officers for this purpose.

19. **E-Banking:** Internet Banking or e-banking means any user with a personal computer and a browser can get connected to his banks website to perform any of the virtual banking functions. All the services that a bank has permitted on the internet are displayed in the menu.

20. **E-Commerce:** Electronic Commerce commonly known as e-commerce consists of buying and selling of products and services over electronic system such as the internet and other computer networks.

21. **Factoring:** It can be defined as an arrangement between financial institutions or bank and a business concern where factor purchased book debts either with or without recourse. In other works outrights sale of receivable is known as factoring.

22. **Financial System:-** Is a complex and well integrated set of sub system of financial institutions, financial markets, financial intermediaries and services which facilitate transfer and allocation of funds effectively and efficiently. It also consists of regulations and laws and practices followed in the system.

23. **Financial Market:-** Financial market refers to those centers and arrangements which facilitate buying & selling of financial assets / instruments. Whenever a financial transaction takes place, it is deemed to have taken place in financial market. There is no specific place or location to indicate a financial market.

24. **Financial Assets/ Instruments:** - Financial Assets/ instruments are a liability of issuer towards holder. It is a claim against a person/institution for payment at a future date and periodic payment in the form of interest or divided . Financial Instruments helps the financial market and the financial intermediaries to perform the important role of channelizing fund from lender to borrower.

25. **Fee based services:-** The income of a bank is commonly divided as interest income or non-interest income. The non-interest income includes fees, commission, services charges, handling charges, holding charges etc. This non-interest income is commonly termed as fee based income and services provided through this fees are known as fee based services.

26. **Forfeiting:-** It is form of financing of receivables pertaining to international trade . The purchase is in the form of discounting the documents like trade bills, promissory notes covering the entire risk of nonpayment in collection of dues. All risk of collection problems are of purchaser (Forfeiture).

27. **Fractional Reserve Banking:-** Is a type of banking where depositor invest money in a bank and have the ability to earn interest rather than having to pay to hold the money. The bank takes ownership of base money entering the bank, uses it to maintain highly liquid reserve to repay expected customer withdrawal and pay for bank operation and in term gives the customer a credit to his account which the bank ensures can use as money to buy goods and services anywhere in the economy.

28. **Fund based services:-** Are those services where funds of a bank are involved such as different types of loans granted by bank e.g. clean loan, pledge, hypothecation , housing ,vehicle loan ,education loan etc. Banks earns interest on such loan by involving its funds. Such services are known as fund based services.

29. **Insurance Regulatory and Development Authority (IRDA):-** IRDA came in to being in 1999 under IRDA Act to protect the interest of insurance policy holder and to regulate and promote an orderly growth of insurance industry and all intermediary companies dealing with life and non-life insurance in the financial system of India.

30. **Letter of credit (LC) :-** LC is a type of guarantee given by a bank on behalf of its customer to make payment of goods and services to the supplier on presentation of documents as required as per term of contract. LC is often used in international trade by importer.

31. **Loan Syndication :-** It is almost similar to consortium finance. It is a arrangement between one or more lending institution to provide a borrower credit facility using common loan documentation. However, this is generally resorted to in international trade.

32. **Money Market:** - It is a market for short term money and financial assets that are near substitutes of money. Here dealing are for a short period ranging from one day up to one year and financial assets can be converted into case easily with minimum cost examples of money market are call money market, treasury bill market, certification of deposit etc.

33. **Merchant Banking: -** Merchant Bankers are issue houses which manage new issues of companies. As per SEBI Act' 1992 "any person who is engaged in the business of issue management either by making arrangements regarding selling, buying or subscribing to the securities as manager , consultant ,advisor or rendering corporate advisory services in relation to such issue" is known as merchant banker.

34. **Micro Finance:** - RBI has defined micro finance as provision of thrift and credit and other financial services of a very small amount to the poor in rural ,semi

urban and urban areas to improve their income and living standard. Micro-finance institutions are those which are engaged in providing these facilities.

35. **Mutual fund:**- Mutual funds are special type of institutions which act as financial intermediary in investment business. Mutual funds mobilize funds/savings of small investors and households by selling their own shares also known as units and pass on the return there of to the fund investors for their involved money.

36. **Multiple banking arrangements: -** When a borrower meets his credit needs not from one but from a number of banks, it is known as multiple banking arrangements. In such case banks has to be careful in advancing loan.

37. **NABARD:** - National Bank of Agriculture and Rural Development was established in 1982 as a development financing institution with a mandate to promote integrated and sustainable rural development and secure prosperity of rural areas. It performs supervisory, promotional and regulatory functions in respect of rural credit institutions.

38. **Non-performing assets (NPA's):**- A bank balance has both performing and non-performing assets. Performing assets are those on which interest and principal are received when due. Non-performing assets are those on which interest and principal are not received when due. RBI look a decision that such NPA's which are not received within 90 days from the date due, they would be treated as NPA and provision would be made as per guidelines issued by RBI.

39. **Reserve Bank of India:**-Established under RBI Act 1934 as central bank of the country and bankers bank. It exercise control on the banking industry through RBI Act and Banking Regulation Act 1949. It is also responsible for announcing monetary and credit policy in the country as a central bank.

40. **Retail Banking:**- Retail banking refers to banking in which banking institutions execute transactions directory with consumers rather than corporations and other banks. It is a typical mass banking where individual customers use local branches of commercial banks. As compared to corporate banking, the amount of each transaction is small.

41. **Regional Rural Banks (RRB's) :-** In order to implement 20 point economic programme, Govt. of India came up with the idea to set up RRB's and for this RRB's Act was passed in 1974 . These RRB's were set up to supplement the efforts of cooperative credit institutions in rural areas. They are joint ventures of central Govt. , State Govt. , and sponsored bank & their share capital contribution is 50%, 15% & 35% respectively.

42. **Real Time Gross System (RTGS):-** RTGS is a important mile stone in Indian banking system through which cheques and transfer of money from one bank to other is credited in customers account on the same day. The settlement of account takes place through RBI.

43. **Repo and Reverse repo rate:-** Repo rate is rate at which RBI provides short term loans to commercial bank. Presently this rate is 7.5%.
    Reverse repo rate: - is rate at which RBI accepts surplus money of commercial banks. Presently this rate is 6.5%.

44. **Rural Finance:-** It encompasses the range of financial services offered and use in rural areas by people of all income levels . It includes financing agricultural activities (input supply, production , distribution , processing , marketing) and micro-finance for poor and low income people.

45. **Statutory Liquid Ratio (SLR):-** As per section 24 of BR Act'1949, each bank is required to maintain SLR in the form of encumbered govt. and govt. approved securities of its total time and demand liabilities. Presently this SLR is 24% Banks have to submit a periodical return to RBI in this regard.

46. **SARFAESI Act 2002:-** This act was passed to create a new legal frame work to recover dues of banks and financial institutions particularly NPA's . Special feature of this act is that no court can intervene in the matter when proceedings to recover loans have been started under this act.

47. **Securitization: -** Means acquisition of financial assets by a securitization & Reconstruction Company (SRC) by a mutually agreed terms and conditions to reduce large NPA's. It is a process in which illiquid financial assets are converted in to marketable securities.

48. **Service Area Approach:-** Special scheme implemented since 1989 under which each bank branch i.e. cooperative bank ,RRB Commercial bank is allotted a specific service area consisting of 15-20 villages for conducting survey preparing credit plan of residents and arrange to meet their credit requirements.

49. **Self Help Groups (SHG's):-** A SHG is a group of about 20 people (man or woman) from economically homogenous class who came together for addressing their common problems. They promote savings , arrange loans out of these savings to needy, arrange loans from banks and help members to become self reliant.

50. **Security &Exchange Board of India (SEBI):-** SEBI was made a statutory body under SEBI Act 1992 to monitor and regulate capital market activities and to promote healthy development of capital market. Its basic aim is to protect the interest of investors in securities by properly regulating security market.

51. **Universal Banking System:** - A Universal Bank is a one stop shop which deals with vide portfolio of financial products integrating project financing , commercial banking , term lending, investment banking , retail operations , mutual funds , pension funds, underwriting, insurance etc. In universal banking more customers are served with the same existing network which ultimately benefits their customers with low cost of services.

52. **Unit Banking:-** When a bank from a single unit without any branch anywhere , it is known as unit bank. Generally this term is not common in case of commercial banks. However, in the field of urban credit there are few urban cooperative banks which do not have any branch and thus acts as a unit bank.

53. **Underwriting: -** is an assurance by a bank, financial institution a form to purchase shares/debentures if some portion of the issue remain undersubscribed. For this assurance, they change underwriting commission.

Bibliography

Suggested Readings

1. Money Banking & Finance by N.K. Sinha
2. Report of Trends & Progress of Banking in India 2007-08 – RBI
3. Annual report of NABARD 2007-08
4. Principles of banking – Indian Institute of Banking & Finance, Mumbai.
5. Modern Banking (Theory & Practice) By D. Murlidharan

Questions in the form of Quiz, fill in the blanks, true or false, multiple choice etc. on the subject of Banking Services Operations of Sem. IV of MBA (RTU)

1. In the latest of monetary Policy announcement by RBI in the Repo Rate and Reverse Repo Rates have been revised. The revised rates are as follows:

   (i) Repo Rate (a) 7% (b) 7.50% (c) 7.75%
   (ii) Reverse Repo Rate is (a) 6% (b) 6.30% (c) 7%

2. Presently, the Bank Rate is :

   (a) 6% (b) 6.5% (c) 6.75%

3 As per provisions of SARFAESI ACT 2002, a notice is required to be given to the defaulter debtor. This notice period prescribed is (a) 3 months (b) 60 days (c) 6 months.

4. A general provision is required even standard assets. The rate of provision is (a) 10%, (b) 20% (c) 25%

5. For treating the loan as NDA, the period of default has been reduced which is now (a) 90 days (b) 180 days (c) 60 days

6. Present rate of CAR (Capital Adequacy Ratio) or CRAR (Capital to Risk Asset Ratio) is (a) 11% (b) 10% (c) 9%

7. The SARFESI ACT 2002 is applicable on cooperative bank also (True or false).

8. The SARFAESI ACT 2002 is also applicable on RRB's (true or false)

9. Co-operative Agr. & Rural Dev. Banks can accept saving deposits from public (true or false)

10. The present rate of CRR (Cash Reserve Ratio) is (a) 6% (b) 5.50% (c) 4.00%

11. The Regional Rural Banks are joint ventures of Central Govt., State Govt. and Sponsoring bank. Share capital contribution of all these three is ------------% respectively.

12. The National Bank for Agriculture & Rural Development (NABARD) was established in the year (a) 1980 (b) 1982 (c) 1985

13. The RBI was established in the year ______ and nationalised in the year ______

14. The Prevention of Money Laundering Act (PMLA) was passed in the year _____ and AMLA Rules came in force in the year _____

15. A Banking Company in India is registered under (a) RBI Act (b) Banking Regulation Act (c) Indian Companies Act.

16. There is a specific term used for combining bank products and insurance product is known as _______

17. Type of guarantee issued by importers bank issued in favour of exporter is known as ____________

18. The word CRM stands for _______ ________ __________

19. The word ALM stands for ________ _________ ___________

20. The selling of NPAs to Reconstruction Company is known as ___________

<u>Answer Keys</u>:

1 (1) c, (ii) (b), 2 (a) 3(b) 4(c) 5(a) 6(c) 7(true) 8(false) 9(false) 10(c) 11. 50-15-35 12,(b) 13.1934&1949 14. 2002 & 2005 15(C) 16.Bancassurance 17.Letters of credit 18.Customer Relationship Management 19.Asset Liability Management 20.Securitisation