

**ANSWERS
OF
RTU QUESTION PAPERS
SUBJECT: BANKING SERVICES OPERATIONS(M-406)
FINANCE: MAJOR & MINOR
FOR THE
YEAR 2009,2010 & 2011**



PREPARED

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RTU QUESTION PAPER 2009

SUBJECT: BANKING SERVICES OPERATIONS (MAJOR)

Question 1 “In the old system of clearing cheques, issuer could use the clearing float but with innovation of sophisticated clearing system, it is difficult to use clearing float” explain.

Answer : Clearing can be defined as an arrangement through which a bank exchanges cheques drawn on other banks for those drawn on it. This exchange is done at clearing house. This clearing house is a organization of various banks constituted for the purpose of off setting inter bank indebtedness arising from the transfer of deposits by a customer of a particular bank to another bank. Generally main branch of RBI or SBI acts as a clearing house where all member banks have their account for clearing purpose and maintain prescribed minimum balance in the account.

Float : Float indicates difference between bank balance shown by bank books and shown by the book of the firm & bank pass book. This float arises due to time gap between cheque written / issued and time when it is presented or time gap between cheque deposited and time when credit is actually given by the bank to the firm. This time gap (Float) may be :

- Postal Float : Time required for receiving cheques from customers through post
- Deposit float : Time required to process the cheques received and depositing them in bank
- Bank Float : Time required by banker to collect the payment from customers bank.

For example 'A' of Jammu issues a cheque on 1.5.2010 of UCO Bank Jammu to his supplier 'B' of Jaipur and sends this cheque of Rs. 50000/- by Registered Post. B receives this cheque on 5.5.2010. After processing, he deposits this cheque in his bank i.e. SBBJ Jaipur brach on 8.5.2010. Since it is a out station cheque, the collecting bank i.e. SBBJ would send this cheque for clearing. In this process of clearing 'A' account in UCO Bank Jammu was debited on 13.5.2010 and 'B' account in SBBJ was credited on 16.5.2010. In this example 'A' debited Rs. 50000/- in his books on 1.5.2010 but actually bank debited it on 13.5.2011 in 'A' account in UCO Bank Jammu. So "A" gets a float of 12 days during which he could have used this amount of Rs. 50000/- for other purposes.

However, with innovative and sophisticated clearing systems, the issuer of cheque is not in a position to use this float. Some of the examples of these innovative techniques are as follows :

1. CBS enabled cheques : Now most of the banks have started issuing core banking service related cheque books to its customer and such cheques issued are payable at par in all cities. They work like draft and credit to customer account is given

within a short period of 2-3 days. It is also known as cheques issued from multicurrency cheque book.

2. Clearing House Automated Payment System (CHAPS) : In this electronic managing system, all transactions are transmitted in code to help reduce the risk of fraud. In this system, local transfer of funds would be cleared on the same day which allows customers to treat amount so transferred to them as cash available.
3. Real Time Gross Settlement : In this system a customer who wants to remit money to his creditor can transfer/remit money and the transaction is completed on the same day within two hours. Hence, a person remitting money can't use this money for other purpose as he used to do in old system of clearing.

From the above, it is clear that use of float by issuer of cheque is no more possible with innovative and sophisticated system of making payment.

Question 2 Write short notes on any three

- 1- NABARD
- 2- CARDB
- 3- NBFC
- 4- NBFC SARFAESI ACT

Answer : (1) NATIONAL BANK FOR AGRICULTURE & RURAL DEVELOPMENT (NABARD)

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 :

- (i) 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 Agri Credit Co-ops, co-op. Agr. & Rural Dev. Bank)
 - Other financial institutions approved by RBI.

- (ii) Promoting Institutions building (e.g. Farmers' clubs, Farm Hatts, Rural marts etc.)
- (iii) Coordinating operations of rural credit institutions.
Evaluating, monitoring and inspecting rural credit institutions.
- (iv) Acting as regulator for cooperative banks and regional rural banks.
- (v) Maintaining liaising with Central Govt, State Govt., 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.

(2) COOPERATIVE AGRICULTURE & RURAL DEVELOPMENT BANKS (CARDB'S)

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, 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.

NABARD is refinancing the loan amount to State CARDB BANK. 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.

(3) NON-BANKING FINANCE COMPANY (NBFC)

NBFC'S are financial institutions that provide banking services without meeting legal definition of bank. This company does not hold a banking license. They are not allowed to accept deposits. A NBFC is a company registered under the companies Act 1956 and is engaged in the business of :

- Loans and advances

- Acquisition of shares/stocks/bonds etc issued by govt. or govt. authorities
- Leasing
- Hire purchase
- Insurance business
- Chit business

NBFC'S are doing functions akin to that of banks. However there are few differences such as :

- A NBFC can accept demand deposits like current/saving.
- A NBFC is not a part of payment and settlement system and as such cannot issue cheque books to its customers.
- NBFC's are not covered under deposit insurance facility provided by DICGC

As per requirements of RBI Act 1934, it is mandatory that each NBFC should be registered with RBI. However to obviate dual regulation certain category of NBFC's which are regulated by other regulators are exempted from registration with RBI. The examples of such NBFC's are :

- Venture capital fund/merchant banking companies/ stock broking companies registered with SEBI
- Insurance companies holding a valid certificate of registration issued by IRDA
- Nidhi companies registered under section 620 A of companies Act 1956
- Chit fund companies as defined under chit fund Act 1982
- Housing finance companies regulated by National Housing Bank

(4) SECURITIZATION AND RECONSTRUCTION OF FINANCIAL ASSETS & ENFORCEMENT OF SECURITY INTEEST ACT 2002 (SARFAESI ACT)

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 of 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 of 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.

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

Question 3 Banks are hub for providing fee based and fund based financial services. Discuss these services.

Answer : Banks are really hub as they provide a services of fee based and fund based services. In fact their income/revenue comes from two sources i.e. interest income from financial assets, loan & advances given to the customers and investments in money market and govt. securities. Non interest income come from fees service charges, handling charges, inspection charges etc. This non-interest income is commonly known as fee based income and such services provided are known as fee based services.

Fee based services : can be classified in to two i.e.

1. Corporate fee based services
2. Retail fee based services

(1) Corporate fee based services are :

- Cash services i.e. collection, payment etc.
- Merchant banking
- Acting as registrar, under writing and custodian services
- Foreign exchange services

- Bill discounting
- Factories
- Forfeiting
- Leasing
- Credit rating
- Letters of credit and bank guarantee

(2) Retail fee based services

- Credit cards
- Debit cards
- Smart cards
- Personal tax counseling
- ATM facilities
- Foreign inward/out ward remittances
- Fund transfer facilities through cheques, bankers cheques, demand draft, telegraphic transfer, mail transfer, RTGS etc.
- Safe deposit lockers / safe custody facilities
- Utility bill payment
- Portfolio management
- On line trading

Interest income or fund bases income comes from various fund based services provided by banks in the form of :

- Loans & advances to customers

Home loan, vehicle loans, education loan, business loans in the form of clean limit, pledge loan, hypothecation cash credit, overdraft, agricultural loans, loan against FD'S, NSC etc.

- Investment made it money market

Call deposits, treasury bills, certificate of deposit, commercial paper, surplus cash parked with RBI on reverse repo rate.

(3) Investments Made in Govt. Securities

Each bank is required to invest 25% of its total time and demand liabilities to maintain Statutory Liquid Ratio (SLR) in govt. and govt. approved securities on which bank gets regular income though rate of interest is a bit low.

Hence, it can be concluded that banks are hub for providing various fee based and fund based services as explained above.

Question 4 In the recent post, banking system has passed through multiplicity of crises and problems. Discuss the root cause of the crises and way out to fight such crises.

Answer : In the year 2008 and 2009 world wide recession was on peak adversely effecting even the banking sector in India. The problem originated from most developed country like USA where many banks failed due to this crisis. Lot of credit/ loans were availed by American people and they found it difficult to repay the loan. It was revealed that in a small family, number of credit cards went up to 9-10 and all these cards were used. Similarly, housing loan was taken from banks which could not be repaid in time. Due to recession, production of goods and services came down which further aggregated the problem & gave rise to liquidity crises in market. Due to this recession, many companies reduced their production capacity and owners started job cuts and retrenchment of employees to curtail the expenditure.

Indian banks were not much effected by this worldwide recession because of very strong financial system and strong policies of RBI to monitor and control over Indian banks. However, our banks faced some problems like :

- Liquidity crises
 - Fall in interest rates and as a result deposit growth rate come down
 - Many new cases of dishonor of cheques were noticed
 - NPA's of some of the banks went up particularly with reference to cooperative banks.
-
- Banks were not in a position to meet full demand of loans & advances.
 - Norms of loans and advances were made move stringent
 - Net profit of some banks declined.

Now this problem of banks is over and the greatest challenge before RBI is to control rising inflation for which RBI has taken strong decisions. RBI has raised Repo rate and reverse repo rate 8-9 times during 2010-11. Interest rates on deposits have gone up and as a result again, growth rate of deposit and loans & advances has started rising.

Our RBI is strong enough to take suitable measures and as a result such crises is not going to repeat through our banks were not effected much by this crises which originated from USA during 2008.

Question 5 Write note on any two

(i) Securitization of debts (ii) NPA & provisioning for it (iii) CAR

Answer

Capital Adequacy Ratio (CAR)

CAR is a ratio of capital fund of a bank to risk weighted assets. This capital fund consists of two broad groups i.e. :

Tier I : This tier one capital otherwise known as core capital provides most permanent and readily available support to a bank against expected losses. It includes :

- Paid up share capital
- Free reserve
- Capital reserve
- Surplus of profit

Tier II : it consists of elements that are less readily available to meet expected losses.

This tier II would include :

- Undisclosed reserve
- Investment fluctuation reserve
- Re-valuation reserve
- General provisions and loss reserve
- Hybrid debt capital instruments & subordinate debt

Risk Weighted Assets : Means weighted aggregate of funded and non-funded items. The degree of risk in each item of asset is expressed as percentage weighting of assets in balance sheet and each asset is multiplied by relevant weights to calculate total of risk weighted assets. These risk weights to assets are prescribed by RBI and some changes in these risk weights are also notified by RBI time to time. Presently this CAR/CRAR is 9%. It tells the adequacy of capital fund of a bank in relation to risk weighted assets.

1- Securitization of debts : Securitization (s) refers to the process of liquidating illiquid long term assets like loans/receivables of financial institutions like banks by issuing marketable securities against them. It is a technique by which long term, not negotiable and high valued financial assets are converted into securities of small value which will be traded in market.

Through this process of 'S' banks can remove long term assets from balance sheet by replacing them with liquid cash through issue of securities against them. In these long term assets, funds of banks are blocked unnecessarily for long term. Now this is readymade solution for them. This 'S' helps in recycling of funds at reasonable cost and with less credit risk. This process of 'S' provides liquidity through tradable financial instruments. Entire transaction of 'S' is carried out in asset side of balance sheet i.e. one asset (ill-liquid) is converted into another asset (cash).

Hence 'S' is nothing but liquidating assets comprising loans and receivables of an institution through systematic issuance of financial instruments. In the operational mechanism of 's' following parties are there.

- (i) **Originator** : The bank or financial institution which decides to go for 'S'
- (ii) **Special purpose vehicle (SPV) or a Trust** : The institution which is ready to help originator by outright buying such assets.
- (iii) **Merchant banker or investment Banker** : They act as SPV
- (iv) **Credit Rating Agency** : Which rates the 'S' assets
- (v) **Servicing agent or receiving & paying agent** : An agency which collects money from 'S' assets. Even originator can take this responsibility.
- (vi) **Original borrower or obligor** : Principal debtor of 'S' assets.
- (vii) **Prospective investor or buyers of securities issued by SPV or Trust buying 'S' assets.**

Various Stages Involved in Securitization are :

- (i) **Identification** : Originator has to identify assets to be securitized of homogeneous nature considering their maturity, interest rate, frequency of payment and marketability.
- (ii) **Transfer Process** : After identification, selected pool of assets are passed through another institutions i.e. SPV or Trust through outright sale or through collateralised loan is known as transfer process.
- (iii) **Issue process** : In this stage, SPV issues securities to investors in the form of securities of smaller values. These securities are sold to investing public. These securities are called

“ Pay through certificates “

“ Pass through certificates “

The payment schedule of such securities is fixed in such a manner that it matches with repayment of securitized assets.

- (iv) **Redemption stage** : The repayment of interest and principal amount of securities issued is facilitated out of collections made by SPV from 'S' assets. For this purpose, collection agents are appointed on commission basis or originator does this work of collection.

The credit rating agencies rate such securities issued by SPV to facilitate their easy marketability.

The Merchant bankers play role in this process of 'S' by way of acting as :

- SPV
- Underwriting issue of securities by SPV
- By undertaking issue Management of securities to be issued by SPV
- Structuring issue of securities and ensuring completion of legal formalities for such issue

Two keys parties – Whose role is crucial in this whole process of securitization, are

(i) Original borrowers : Who have to fulfill their commitments of paying the loan & interest taken from bank ?

(ii) Investing Public : Who are buying the securities issued by SPV ?

The following type of assets are considerable suitable for securitization.

- Term loans to financially sound/reputed companies.
- Receivables from Government Departs./Companies.
- Credit card receivables.
- Hire purchase loans like vehicle loans.
- Lease finance
- Mortgage loans

Advantages of Securitization :

- Additional sources of funds to originator
- Greater profitability – Through recycling of funds, increase business turnover.
- Raises/Enhances – Capital adequacy ratio (CAR)
- Spreading Risk – Amongst institutions like SPV, Investor public, merchant banker.
- Helps originator to have easy access to security market.
- Better rate of return
- Avoids idle capital
- Securities issued are : better than traditional securities as they are backed by securitized assets.

Due to advantage of securitization, there is a vast scope for commercial banks to go in for securitization.

Another Dimension of Securitization is to reduce mounting NPAS under SARFAESI ACT 2002 which is explained below.

Securitization is the process of transforming the assets of a lending institution in to negotiable instrument. It means acquisition of financial assets by a securitization or reconstruction company (SCRC). This process is resorted to reduce large non-performing assets of a bank or financial institution buy SCRC. This is a process where non liquidated financial assets are converted receivables and other assets in to securities in security receipts that can be placed in market for trading.

On acquisition of financial assets, the SCRC becomes the owner of financial assets and steps into the shoes of lender bank or financial institution. The RBI is the regulatory authority for SCRC which is company registered under the companies Act 1956 for the purpose of securitization. It needs registration with RBI under SARFAESI ACT 2002.

- Positive effect on balance sheet : Securitization is an accounting arm related to removal of debts from the balance sheet of a bank/financial institution. A bank would find it easy to be in conformity with the capital adequacy norms laid down by RBI.
- Increase in income : Bank can earn income in the form of service charges from selling the loan and than for servicing new loans.
- More loans with the same liability : The cash flow obtained by selling the old debt in the form of securities can be used to lend funds further at a profit to bank. Hence against same amount of liabilities, lending of banks increases.

2- NON-PERFORMING ASSETS (NPA'S)

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 of principal is not received when due. The RBI took a decision that if this amount is not recovered within 90 days from the date if becomes due, it would be treated a 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 Govts.
- 2- Loans against FD/NSC/IVP/KVP is adequate margin has been maintained.
- 3- Loans which have been rescheduled for the purpose of repayment.

Gross & Net NPA

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.

Classification of NPA'S & Provisioning Norms

- 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 Assets : 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.

Question 6 "Micro Finance is a tool to eliminate evils, like unemployment, poverty and it also helps in the empowerment of women" Discuss.

Answer : Micro finance as 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 finance institutes are those which are engaged in providing credit and facilities to these poor strata of the society. RBI has asked banks and financial institutions to form their own schemes, models , prescribe suitable criterions, choose suitable branches, credit norms and interest rates etc. for this purpose.

The nongovernmental organizations (NGO'S) voluntary organizations and self Help Groups (SHG'S) are playing crucial role in micro-finance facilities. Even NABARD is playing an active role in supporting these organizations and arranging financial assistance to them. Similarly, many states have also launched various schemes of

micro finance for increasing income of poorest of the poor and for providing them additional source of income and employment.

Micro finance products are

1. Micro savings : creating habit to save and use this saving for future contingencies as well as using the savings for small business activities.
2. Micro insurance : various types of insurance products like life insurance, property insurance, health insurance etc. at nominal rates/premiums to poor people.
3. Micro leasing : Allowing poor entrepreneurs to take on lease equipments, machinery which they can afford.
4. Micro Money transfer : A service of transferring money from one place to other by poor families to their friends, relatives in India & abroad.

The first and foremost objective of micro-finance efforts is to remove poverty by providing finance to poorest of the poor so that this strata of society could make use of this money for income generating activities. In India, large number of self help groups are working which collect savings from their members and provide these savings to needy members for undertaking small business activities which may provide them some employment and source of income generation.

Micro finance has also played a very crucial role in women empowerment. Many self help groups are there which are solely of women. World known micro finance institutions is Grameen Bank Bangladesh led by Dr. Mohammad Yunus which services more than 2.5 million members of which 94% are women. In India many self help groups of women are engaged in the task of women empowerment besides removing poverty and overcoming problem of unemployment. In these self help groups of women, they also learn the art of managing the groups, conduct regular meetings of the groups, work as spokes man of the group in banks/financial institutions. In the state of Gujarat there is institutions which is fully managed by women. Its name is SEWA i.e. Self Employed Women Association which also runs a bank for facilitating finance facilities to women.

Hence it can be concluded that micro finance is key tool to remove poverty, problem of unemployment as well work as a great source of empowering women and thereby provide great help in bringing women in the main stream of economy.

Question 7 CASE STUDY

This tendon committee was set up by RBI under the chairmanship of Mr P L Tandon. One of the area of recommendation was "Maximum permissible bank finance (MPBF). This committee suggested following 3 methods of working out MPBF.

First Method : Total current assets (CA) less current liabilities (CL) and a maximum of 75% of gap can be MPBF.

Second Method : A borrower to provide for a maximum of 75% of CA less CL

Third Method : This method is same as second but excluding core current assets from total CA's

MPBF as per first method

Current Assets Rs. 23,00000 - C. Liabilities Rs. 600000/- = 170000

75% of Rs. 1700000 i.e. Rs. 1275000/-

As per second method

75% of current assets of Rs. 2300000/- comes to Rs.1575000 Less

Current liabilities of Rs. 600000/-

MPBF = Rs. 975000/-

As per Third method

Total CA Rs. 2300000/-

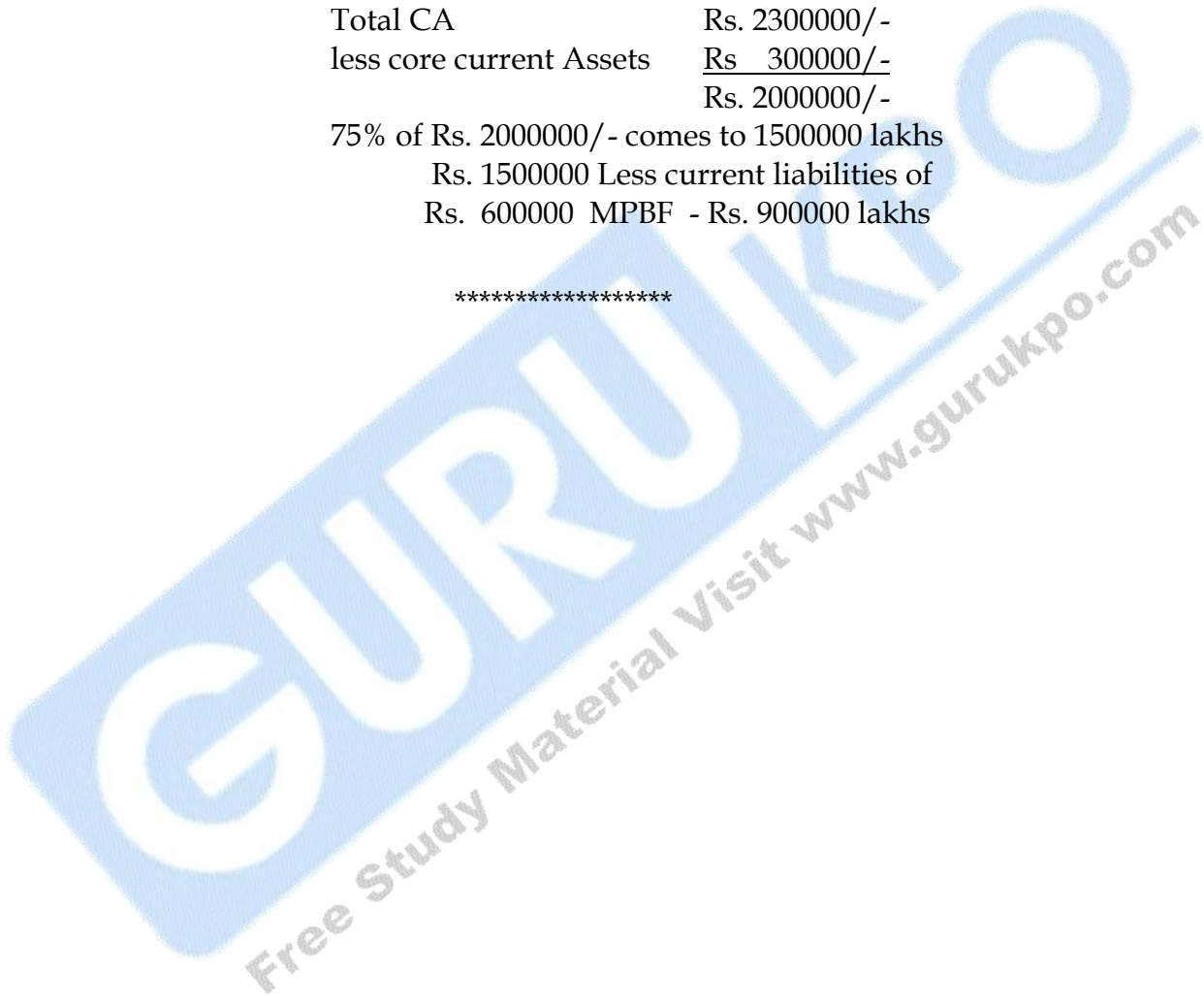
less core current Assets Rs 300000/-

Rs. 2000000/-

75% of Rs. 2000000/- comes to 1500000 lakhs

Rs. 1500000 Less current liabilities of

Rs. 600000 MPBF - Rs. 900000 lakhs



RTU QUESTION PAPER 2009
SUBJECT : BANKING SERVICES OPERATIONS (MINOR)

Question 1 Describe nature and composition of Indian Financial system. Critically examine its role in strengthening national economy.

Answer : Finance refers to borrowing and lending of funds or demand & supply of funds of all individuals, institutions, companies and govt. It includes many institutions, and mechanism that effect the generation of savings, mobilization of savings and distribution of savings to those who demand these funds for investment purposes. Hence, Indian financial system is a complex and integrated subsystem consisting of following :

(i) Financial Markets : Organized & unorganized

Organized consists of

- Money Market : call money market, inter bank money market, Treasury bill market, Certificate of deposit commercial paper
- Capital Market : industrial security market, govt. security market long term loan market.

(ii) Financial Intermediaries

- Banking intermediaries: commercial banks and cooperative banks.
- Non banking intermediaries : like LIC, GIC, UTI etc.

(iii) Financial Assets/Investment

- Primary - like shares, debentures
- Secondary- Issued by intermediaries like UTI bond, mutual fund etc.

(iv) Financial Services

- Fee based services
- Fund based services

(v) Regulatory Bodies

- RBI for banking sector
- SEBI for stock market
- IRDA for insurance sector

Role of financial system in economic development

Economic development of any country depends upon the existence of a well organized financial system. A financial system is an integrated set of financial institutions (financial intermediaries), financial markets, financial assets/instrument and financial services which facilitate transfer and allocation of funds efficiently and

effectively. Through this system, funds flow from areas of surplus to areas of deficit. The financial system is concerned about money, credit and finance.

Financial system provides an ideal linkage between depositor & investor, thus encouraging both savings and investment. It also promotes efficient allocation of financial resources for socially desirable and economically productive purposes and thus influences both quality and pace of economic development.

Role of Financial System Economic Development - Economic development is generally characterized by rise in national and per capita income. This improvement in income in turn facilitates :

- Large savings
- Increase capital formation
- Greater Technological development

These larger savings and capital formation leads to :

- Rise in per capita availability of capital resources
- Improvement in skills due to technological development
- Efficiency and earning power of labour
- Better organization of production
- Development of means of Transport & Communication
- Rise in standard of health and education and expectation of life
- Greater leisure and increased recreation facilities
- Growth of financial institutions & widening mental horizons of people

The essence of economic development lies in growth of output or real income per head of population. Economic growth means transformation of an economy from the state of :

- Under developed to developing and developed
- From a agrarian to a highly industrialized society
- From a low saver to high saver
- From a predominately rural to predominantly urbanized society

The development of economy and transformation of economy as indicated above is largely due to influence of financial system. The adequate supply of finance not only increases national income but also leads to greater employment opportunities, improvement in the standard of living and social welfare. In fact all three crucial components of production i.e. man, material and money have to bring desired results. Human capital and physical capital can be bought and developed with money. In real sense, money, credit & finance are the life blood of economic system and are part of financial system. Hence, a well developed financial system can contribute significantly to the acceleration of economic development.

Some Indian example can be narrated in this regard. First of all, RBI as a central bank of the country and regulator of banking institutions plays a crucial role in the development of economy through its monetary and credit policy as well as by making available money to commercial banks for investment in core sectors of economy like agriculture, industry and infrastructure sector/ services sector. It also

provides loans to central/state governments for various developmental activities. Through its monetary policy and central mechanism, RBI has recently taken measures to control inflation which is major problem faced by our country. Under the overall guidance and control of RBI, commercial banks, and cooperative banks are collecting large amount in the form of deposits and convert that amount into investment meeting the requirements of agriculture, industrial as well as infrastructure sectors. Similarly, various developments financing institutions like NABARD, NHB, IDBI, IFCI, IRBI and playing key role of providing credit to their respective sectors like banks and development finance institutions. Insurance companies, which are dealing with life and non-life insurance are collecting large amount of savings from public in the form of premium and investing the amount collected from public to various needy sectors of economy like agriculture industry, infrastructure etc. Insurance companies dealing with life insurance have collected more than Rs. 2.61 lakh crores as premium from public during the year 2009-10 and have played a key role in the Indian Financial System. Out of such huge amount collected major amount is invested for economic development of country.

Question 2 “Through productive efforts bank finance should make people credit worthy and turn them into people of means” critically examine the statement and in its light describe the basic principles of bank lending.

Answer : Most of the loans provided by banks to individuals, business community and companies are given for productive purposes with a view to increase business turn over, improve profitability and thereby improve their overall image in market and finally improve their credit worthiness and turn them with people of means. Some of the loans are also provided to improve their efficiency and living standard. For example loan for housing and two/four wheelers, consumer durables are provided to improve the image of loanee in the society. A person with his own house is seen with prestige, dignity in the society. Education loan is given by the banks to students for perusing higher education in the field of engineering, medical, management etc. to enable the students to acquire special knowledge which would help them in seeking good employment. They repay this loan out of their earnings when they get employed or start their own business.

Hence all bank loans aims at making the borrower more credit worthy and make him capable of acquiring means of earning

There are four basis principle of lending which a banker keeps in mind while lending. These four principles are :

- Safety
- Liquidity
- Profitability
- Yield

Safety : The first and foremost aspect seen a before loaning is safety of funds in the hands of borrower. In also depends upon the type of security offered for loan. For

example loan granted against mortgage of house is safe as security for loan is house itself which has been mortgaged with the bank. However at the time of analyzing credit worthy ness of the borrower, five C's are normally seen by the bank. These 5 C's are :

- Character
- Capital
- Capacity to repay
- Collateral
- Conditions

Liquidity : It means that loan is likely to come back after the specified period for which loan has been granted.

Profitability : Loan granted will provide reasonable earning to the bank which would help the bank in improving its profit.

Yield : Return on the loan in the form of interest income would provide reasonable yield on investment in loans. Here, it may be mentioned that banks are required to invest funds in govt. and govt. approved securities but yield on such investment is not attractive. This investment under statutory liquid ratio is Statutory / mandatory as per Banking Regulation Act and hence banks are required to compromise on yield. However in case of loans, banks would like to increase their yield by charging higher interest rates.

Question 3 Describe the operation of Real Time gross settlement (RTGS) and National Electronic Fund Transfer (NEFT) facilities used for interbank transfer of funds in India. Explain how these facilitated settlement of transactions in financial markets for trade, commerce and industry.

Answer : **RTGS** : This system is an important mile stone in Indian banking system through which high value cheques and fund transfer from one bank to other are settled and amount is credited in customers account on the same day within 2-4 hours. The settlement of account with two banks takes place through RBI. Each participating bank of RTGS will be required to open a dedicated settlement account with RBI for putting through RTGS settlements. In this system electronic message is sent to another bank through RBI Mumbai and account is settled on the same day. Since the fund transfer instructions are processed and settled in real time, credit and liquidity risks are eliminated. RBI expects it to be one of the most secured systems in the world as information shall not be flowing through public domain but through secured lines.

NEFT : Before introduction of electronic fund transfer, mode of transfer of funds from one bank to other was through demand drafts, mail transfer, telegraphic transfer. However these mediums have their own limitations. Hence in order to facilitate speedy intercity money transfer of funds and ensure effective customer services, RBI introduced EFT Mechanism. In this system any one who want to make payment to another person can approach his bank and can make cash payment or give instructions to transfer funds directly from his account to the account of

receiver and thus amount reaches to the receiver fast. RBI is the service provider for EFT.

Besides above two fund transfer techniques, Electronic Clearing System (ECS) is now a days getting very popular. Under this ECS, amount of repeated nature to be paid by a person is collected by debiting his account every month. Most of house loan financing institutions collect loan premiums through ECS.

These above explained RTGS, NEFT & ECS has helped a lot in faster/speedy settlement of transaction in financial market, trade and industry. A debtor who has to make payment to supplier can use any of these modes and amount is credited in the account of supplier on the same day and supplier is in a position to use this money in his business.

Hence these electronic messaging systems of transfer and settlement of money transactions has proved a great boon in the financial market/trade and industry.

Question 4 In the post nationalization phase due to liberal approach in lending, banks in India faced huge overload of Non-performing Assets (NPA'S) comment on the statement and identify reasons behind high NPA levels in banks and suggest the strategy to set the problem right.

Answer : In the year 1969, 14 major commercial banks were nationalized and 6 more banks were nationalized in 1980. The key purpose behind nationalization of these major banks was to force the banks to lend money to agriculture and other priority sectors so that the condition of poor and weaker sections of community can be improved which is essential for development of the economy.

As a result, liberal approach in lending was perused by banks and money was advanced to such people who do not have adequate security to offer from the angle of safety of funds of a banks. There were many other factors due to which amount of NPA started rising and this amount in banking & financial institutions went up to Rs. 1.10 lakh crores.

Factors for rise in NPA : can be classified in to two i.e.

External factors

- In effective recovery tribunal
- Will full defaults
- Natural calamities like drought, heavy rains
- Industrial sickness
- Change in Govt. policies
- Loan waiver schemes announced by govt.

Internal Factors

- Defective lending policies without looking is to safety, liquidity and profitability aspects of loan.
- Improper SWOT Analysis of borrower
- Poor credit appraisal by banks and financial institutions
- Improper selection of borrower

- Lack of proper follow-up for recovery by banks and financial institutions
- Absence of regular industrial visits to ensure proper end use of loan.

The greatest impact of high NPA's is that these NPA's do not generate any income for the bank and on the contrary banks have to make provision for such NPA's and position in balance sheet regarding such NPA's reduces customers confidence in bank and at times deposits also starts decreasing.

To overcome this problem of NPA's, two types of measures need to be initiated.

Preventive Management

- Proper credit assessment / appraisal and risk management mechanism need to be followed by lending institution.
- Organizational restructuring is required to gear up recovery process
- Compromising with interest rate - high interest loans are more risky and hence one has to keep this fact in mind
- Check/control on border line cases so that such loans do not fall in NPA category.

Curative Management

- Making debt recovery tribunal more effective in speedy recovery of pending cases
- Lok Adalat This institution of Lok Adalats helps in settlement of disputes and hence lending institutions should try this measure
- Securitization Act and establishments of asset reconstruction companies
- Use of the securitization and Reconstruction of Financial Assets and Enforcement of security Interest Act 2002 (SARFAESI Act) a special Act to deal with NPA cases.

Govt. of India also took many legal measures to deal this NPA problem in big industrial units. Some of the steps initiated by govt. are as follow:

- Sick Industrial companies (Special Provisions) Act was passed in 1985
- Recovery of Debts due to Banks and Financial Institutions (RDDFI) Act was passed in 1993 to pave way for setting of special Debt Recovery Tribunals
- Corporate Debt Restructuring (CDR) system was introduced for rephasing the loan to help revival of loanee units.
- SARFAESI Act 2002 was passed specially for overcoming problem of NPA'S

The measure initiated particularly SARFAESI Act has helped a lot in overcoming the problem of NPA's.

Question 5 Describe the nature of client banker relationship. In this background give the significance of “Customer Relationship Management” for a bank.

Answer : A client is a service taker from bank and a customer is person who has a account in bank. Mostly clients are customers but in some cases there may be a client who is not customer but he has visited a bank to purchase a draft by depositing draft amount and commission.

A customer has following type of relationship with banker :

- 1- **Debtor & creditor** : when amount is deposited in a bank, depositor becomes creditor and bank becomes debtor. Similarly, when bank advances money, the loanee becomes debtor and banks becomes creditor. The unique aspect of this relationship is that when money is deposited, depositor has no right to supervise use of money and bank is free to use deposit money in the manner bank likes as per provisions of Banking Regulation Act and guide lines issued by RBI.
- 2- **Principal & Agent** : A customer when he opens a account and deposits money, he acts as principal and bank becomes his agent and what over instructions are issued by the customer, bank is required to follow as his agent. Generally customer gives instruction to pay utility bills, payment of loan installment from his account, payment of taxes etc. It becomes duty of the bank to follow such instructions of his principal failing which bank can be held responsible.
- 3- **Bailer & Bailer** : When a customer takes a locker or deposits his valuable instrument for safe custody, customer becomes bailer and bank becomes bailee and bank is required to ensure safety of such valuables, documents lodged with bank in the manner as if the valuable & documents are owned by bank.

In this background customer relationship management has also become very important these days for banks which is explained below :

CUSTOMER RALATIONSHIP MANAGEMENT IN BANKS

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 an integrated part of marketing strategy of banks. For building relationship for longer period, many banks have started 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

<u>CUSTOMERS</u>	<u>EMPLOYEES</u>	<u>BANK</u>
They feel empowered and have greater access to products & services	Have more time to serve customers and are empowered with information to deliver high quality of products & services to meet customers expectations	Optimum use of resource with greater loyalty a customer satisfaction bank can retain existing customers and can attract new customers due to better CRM.
Offer of products and services can be timed with customers requirements e.g. edu. Loan. With upto date information customers, personalized services can be arranged		Bank executives can better utilize opportunity to increase business of bank and increase the overall profitability

Question 6 Describe deposit products offered by banks. Give important innovations made by bank in India in the recent past.

Answer : Two key primary functions of a bank are accepting deposits from public and use these deposit for loan/advances and investments. Key features of bank deposits are :

- Bank deposits are safe as banks are
 - controlled by RBI
 - covered under Banking Regulation Act
 - Covered under "Deposit Insurance" with DICGC
- Bank deposits enjoy exceptionally high liquidity
- Loans can be raised against bank deposits
- Rate of interest differ from deposit to deposit

Types of deposit accounts : Deposit accounts can be opened by

- Individual
- Joint Accounts
- Partnership Account
- Sole proprietary Account
- Company Account
- Account of govt. companies, Associations, Trusts, Trade unions etc.

Type of Deposit Schemes : Can be grouped under three heads

I Deposit schemes of Indian residents

- Current Account
- Saving Account
- Fixed deposit/Term deposit account
- Recurring deposits under section 80-c of Income tax
- Special term deposit under section 80-C of income tax Act

II Deposit Schemes of Non-resident Indian Accounts

- Non-resident ordinary (NRO) Account
- Non-resident external (NRE) Account
- Foreign currency non-resident (FCNR) Account
- Resident foreign currency (RFC) Account
- Escrow Account
- Exchange earners foreign currency (EEFC)
- Foreign currency Accounts of Airline shipping companies
- Foreign currency Accounts of overseas buyers
- Foreign currency Accounts of Foreign Embassies/Missions diplomats.

III Deposits under National Saving Schemes of Govt.

Government's post offices also act as bank and accept following types of deposits

- Saving Deposit
- Recurring Deposit
- Term/Fixed Deposit

Other Schemes of Deposits

- National Saving Certificates (Tax Saving Investment)
- Kisan Vikas Patra
- Post Office monthly income account
- 15 years public Provident Fund Account

Some innovations made by bank in recent past in these deposit schemes :

1- **Facility of Flexi Accounts** : Most of the banks have extended facility of Flexi Account. This a separate account linked with SB opened by bank and amount

beyond minimum balance of Rs. 10000, 25000, is automatically transferred in this flexi Account in which interest is paid at fixed deposit rate for the period amount remained in flexi. This facilitates higher interest rates to a customer maintaining heavy amount in SB Accounts.

- 2- **Free Insurance** : Some banks have also started free accident insurance benefits for customers maintaining a minimum balance of Rs. 10000/- in SB Accounts.
- 3- **New FD Schemes** : Most of the banks have introduced new fixed deposit schemes for a specified months i.e.
 - Special fixed deposit for 500 days
 - Special fixed deposit for 555 days
 - Special fixed deposit for 1000 days
- 4- Attractive Schemes for senior citizens and payment of interest on compounding basis under which interest becomes more attractive. For example interest rate of 9.75% after calculating compound interest, the rate goes beyond 10%.

Question 7 Case study on Micro-finance questions at the end of the case study

- (i) **Analyze the case particularly by wetting on the philosophy and role of micro-finance in building capacities and developing entrepreneurship in rural areas**
- (ii) **Comment on the strategy of micro-finance institution**

Answer This a case study of SKS Micro-finance aided by ford foundation which addresses the "Ultra Poor" i.e. poorest of poor of a remote village in state of Andhra Pradesh. This institution has framed 10 criteria's for indentifying the beneficiary such as no earning male member, not owing any intangible assets, not having any access to any form of credit etc. Based on these criterion 1400 house holds have been selected from different villages and each member was given Rs. 10000/- in cash to start a venture.

The basis purpose of each micro-finance institution is building capacities and developing enter-premiership amongst the beneficiaries. This capacity building (CB) is done through improving their skills in managing the small business which has been started by the beneficiary. For example, in a kirana store, training and skill development is imparted on the key areas by microfinance institution.

- Purchase of material from best source from where price are most economical
- Proper maintenance of stock of different articles, their price fixation
- Proper accounting of sales and payment of money to the supplier
- Preparation of accounts including profit & loss account & balance sheet

After successfully running a store, based on above skill improvement areas, the beneficiarie's confidence is buildup and he/she start thinking to diversify the stock

range or opening a second kirana store at a place where there is a need of one such store.

Hence, besides capacity building and development of entrepreneurship, a micro finance institution primarily aimed at :

- Removing poverty
- Providing employment and source of income generation to the poorest of the poor.
- It also ensures extending facility of insurance i.e. life and non-life
- It also helps in arranging loan from banks and other financial institutions
- It also helps in creating habit of savings
- It also teaches lessons of management.

The strategies of SKS micro-finance are really good and appreciating. The criterion for selecting to help again those who could not start their business. This SKS finance under its strategies has linked vegetable producers with the market beneficiaries are good eliminating middleman and as a result producers would certainly get good prices of their produce. Similarly, those who started rearing buffalos has been directly linked with fodder producers and milk centers so that milk producers could get better prices of milk.

Hence the strategies of SKS micro-finance are really very good and as a result this institution is going to succeed and would certainly achieve the objectives for which it was set up.

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RTU QUESTION PAPER 2010
SUBJECT : BANKING SERVICES OPERATIONS (Major)

Q.1 Explain the meaning and role of financial system in economic development. Support your answer with suitable example.

Ans. Economic development of any country depends upon the existence of a well organized financial system. A financial system is an integrated set of financial institutions (financial intermediaries), financial markets, financial assets/ instrument and financial services which facilitate transfer and allocation of funds efficiently and effectively. Through this system, funds flow from areas of surplus to areas of deficit. The financial system is concerned about money, credit and finance.

Financial system provides an ideal linkage between depositor & investor, thus encouraging both savings and investment. It also promotes efficient allocation of financial resources for socially desirable and economically productive purposes and thus influences both quality and pace of economic development.

Role of Financial system Economic Development- Economic development is generally characterized by rise in national and per capita income. This improvement in income in turn facilitates:

- Large savings
- Increase capital formation
- Greater Technological development

These larger savings and capital formation leads to:

- Rise in per capita availability of capital resources
- Improvement in skills due to technological development.
- Efficiency and earning power of labour
- Better organization of production
- Development of means of Transport & Communication
- Rise in standard of health and education and expectation of life
- Greater leisure and increased recreation facilities
- Growth of financial institutions & widening mental horizons of people

The essence of economic development lies in growth of output or real income per head of population, Economic growth means transformation of an economy form the state of:

- Under developed to developing and developed
- From a agrarian to a highly industrialized society
- From a low saver to high saver
- From a predominately rural to predominantly urbanized society

The development of economy and transformation of economy as indicated above is largely due to influence of financial system. The adequate supply of finance not only increases national income but also leads to greater employment opportunities, improvement in the standard of living and social welfare. In fact all three crucial components of production i.e. man, material and money have to bring desired results. Human capital and physical capital can be bought and developed with money. In real sense, money, credit & finance are the life blood of economic system and are part of financial system. Hence, a well developed financial system can contribute significantly to the acceleration of economic development.

Some Indian example can be narrated in this regard. First of all, RBI as a central bank of the country and regulator of banking institutions plays a crucial role in the development of economy through its monetary and credit policy as well as by making available money to commercial banks for investment in core sectors of economy like agriculture, industry and infrastructure sector/ services sector. It also provides loans to central/state governments for various developmental activities. Through its monetary policy and central mechanism, RBI has recently taken measures to control inflation which is major problem faced by our country. Under the overall guidance and control of RBI, commercial banks, and cooperative banks are collecting large amount in the form of deposits and convert that amount into investment meeting the requirements of agriculture, industrial as well as infrastructure sectors. Similarly, various developments financing institutions like NABARD, NHB, IDBI, IFCI, IRBI and playing key role of providing credit to their respective sectors like banks and development finance institutions. Insurance companies, which are dealing with life and non-life insurance are collecting large amount of savings from public in the form of premium and investing the amount collected from public to various needy sectors of economy like agriculture industry, infrastructure etc. Insurance companies dealing with life insurance have collected more than Rs. 2.61 lakh crores as premium from public during the year 2009-10 and have played a key role in the Indian Financial System. Out of such huge amount collected major amount is invested for economic development of country.

Q.2 Explain the need for Credit Policy. Critical examine the present credit policy of Reserve Bank of India.

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. RBI controls the supply of money to attain general economic objectives such as:

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

In India, credit policy is 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 agriculture, industry, trade & commerce and other productive 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 and qualitative techniques.

Quantitative Techniques uses 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

The RBI undertakes quarterly review of economy and based on this review, makes policy announcement for the next quarter. During these reviews, by RBI found inflation as the biggest challenges before Indian Economy. Hence to overcome and combat inflation, following policy announcements were made by RBI:

1. Cash Reserve Ratio (CRR) was revised from 5.75% to 6% and as result, RBI estimated that around Rs. 12500 crores would go to RBI from bank and to that extent money supply in market would be reduced which would help in controlling inflation.
2. Repo rates were revised from 6.25% to 6.50% and reverse-repo rate was raised from 5.25% to 5.50% to control inflation so that bank loans become costlier. Similarly reverse repo rate was aimed at controlling inflation as banks would like to keep their surplus money with RBI.

Q.3 Write a brief note on micro finance with special reference to India.

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, prescribes 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 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 refers to the provision of financial services to poor or low income clients including consumers and self employed.

Micro finance products-

(1) Micro savings - creating habit to save money without any minimum limit a day or a month and allow people to retain this money for future use or for unexpected contingencies. In SHG's people are motivated to save money in a group fund and members are allowed to borrow from this group fund for variety of purposes.

(2) Micro Insurance - There are different types of insurance services like life insurance, property insurance, wealth insurance disability insurance which are provided to poor people to protect them from risks.

(3) Micro-leasing- To allow small entrepreneur who can afford to buy at full cost can invested lease equipments, agriculture machinery or vehicles.

(4) Micro-money transfer- A service for transferring money to family or friends within country and overseas. This money transfer without opening current account are performed by a number of commercial banks.

Objectives of Microfinance institutions

- To improve quality of life of poor by providing access to finance and support services.
- To mobilize resources in order to provide finance and support services to poor.
- To create opportunities for self employment for under privileged.
- To train rural people in simple skills. enabling them to undertake income generation activities.

Q.4 Write short note on any two of following:

- i. **The problem of NPA's**
- ii. **NABARD**
- iii. **Regional Rural Banks**

Ans. NON PERFORMING ASSETS (NPA's)

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 principle 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 30.03.2004 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 Govts
2. Loans against FD/NSC/IVP/KVP if adequate margin has been maintained
3. Loans which have been rescheduled for the purpose of repayment.

Gross & Net NPA-

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.

Classification of NPA's & provisioning norms

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

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

This problem of NPA became a crucial problem for banks and financing institutions and the total amount involved in NPA's crossed more than Rs. 1 lakh cores. Due to high NPA's, some of the banks went up to verge of collapse and liquidation.

To overcome this problem, Govt. has to intervene and set up Debt Recovery Tribunals, for speedy recovery of heavy loans of banks and financial institution. In the year 2002, special act in the name of securitization and Reconstruction of

financial assets & enforcement of Security Interest Act 2002 was passed. This SRFAESI Act 2002 gave wide powers to banks and financing institutions for realization of NPA loans without intervention of civil courts.

NATIONAL BANK FOR AGRICULTURE & RURAL DEVELOPMENT **(NABARD)**

NABARD was set up as a “Development Bank” on 12.07.1982 and functions of Rural Credit Debt of RBI were transferred to this bank. It came into being with a mandate 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 Agri Credit Co-ops, co.op. Agr & Rural Dev. Bank).
 - Other financial institutions approved by RBI.
- (2) Promoting Institution building (e.g. Farmer’s 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 liaison with Central Govt. State Govt., 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 banker’s Institute of Rural Development (BIRD) at Lucknow. It raises funds from Govt. of India, RBI, issuing development bonds/debentures and RIDF deposits.

REGIONAL RURAL BNAKS (RRB’S)

Under the 20 point Economic Porgramme during emergency, one of the point was as follows:

“Provision of cheap credit for Marginal farmer’s 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 for which RRB Act passed in 1974. These RRB’s were started in 1975 to supplement the efforts of rural credit co-operatives in the rural areas.

The broad objectives with which RRB’s come into being were as follows:

- To develop rural economy by providing financial assistance to :
 - o Agriculture
 - o Trade, commerce, industry and other productive activities

- To provide credit and other facilities particular to
 - Small & Marginal factors
 - Agricultural laborers
 - Artisans and small entrepreneurs

These RRB's are joint ventures of Central Government, State and sponsored bank with a share capital contribution of 50%, 15% and 35% respectively. A RRB is 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 @ ½% 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 financial assistance to these banks and monitors their working.

Q.5 Explain the role of technology in banking operations to give better services to customers.

Ans. In the growing competitive environment in the economy, it has become essential for Indian banks to observe latest technology and modify it to suit changing scenario. With the entry of foreign banks and highly innovative services offered by private sector banks, it has become necessary for Indian banks to make increasing use of electronic mode of transacting business. Banks are not only required to make greater use of technology to make it, customer friendly, efficient and competitive but also for providing new products and new form of services in increasingly dynamic and globalize environment. A wide range of services are being used using electronic media such as:

- i. **Automatic Teller Machine (ATM)** Also known as "Any Time Banking" : It allows customers to withdraw money at any time from the bank, using accounting information, deposit change or cash. ATM is the most convenient way to withdraw cash any time i.e. 24 hours. It also reduces crowd in bank during banking hours.
- ii. **Tele-Banking** : It is made available with the help of Voice Response System (VRS). It provides round the clock bank-on-phone services to the customers. Customers can perform a number of transaction from their home or office like balance in account, cheque book requisition, money transfer etc.
- iii. **Electronic Fund Transfer (EFT)** : This EFT facilitates transfer of money from one account to other in the same city or other city in the same bank or other banks. Even payment of insurance premium mortgage installments are electronically transferred from one bank to the respective account periodically.
- iv. **On-line Banking**: Doing banking business through home personal computer (PC). Customer demands the necessary application form through the net and bank sends a unique personal password (UPP) for accession. Through this system complete data base the bank about customers account is made available to the customer at his

terminal. Hence customers sitting on their home PC can avail following facilities on line:

- Getting account statements
 - Stop payment of cheque
 - Demand draft / Pay order
 - Opening of FD / Recurring Deposit Account
 - Opening of Letter of Credit
- v. **Demat Account:** Opening of Demat accounts have been introduced by SEBI to regulate and improve stock investing. In this account, details of investments made in shares and securities are kept in electronic form.
- vi. **Clearing House Automatic Payment System (CHAPS) :** This is an electronic messaging system in which all transactions are transmitted in code to help reduce the risk of fraud. Under this system, customers could be assured that local transfer of funds would be cleared on the same day and this allows customer to treat amount so transferred to them as cash available.
- vii **E- Cheques:** The e-cheque system uses network services to issue and process payments that emulate real world **cheque** . The payer issues a digital cheque to the payee and entire transactions are done through internet.
All these technological innovative services offered by bank to customers help the customer do transaction with banks.
- Quickly
 - More conveniently
 - With greater accuracy
 - Without any risk
 - Without any crowding at bank premises

Q.6 What do you mean by customer relationship management in banks? Also explain the importance of CRM.

Ans.

Customer Relationship Management in Banks

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 Executives for relationship banking and meeting 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 consolidated 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 an integrated part of marketing strategy of banks. For building relationship - for longer period, many banks have started 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.

To maintain long term client relationship a bank may provide special benefits to loyal clients eg.

- Lower Bank Charges
- Bank employees should be motivated to acknowledge bank clients
- Personality know regular clients
- Interact with clients and makes clients feel welcome.

A pleasant atmosphere be created in bank branch to ensure that clients feel relaxed, important and that they can trust the bank.

Important benefits of CRM to

- I. **Customers-** customers feel empowered if they have greater access to products and services eg. 24 hours banking
 - More Coordinated and more professional approach to customer contact.
 - Targeted products and offering can be timed to coincide with customer's event and life stages e.g. education loans.
 - With up to date customer information, banks can prepare themselves with more personalized services.
- II. **Employees-**
 - Employees have more time to serve customers and fulfill customers expectations.
 - Employees can deliver high quality services to customers.
 - Employees have higher satisfaction rating from customers.
- III. **Banks-**
 - Optimum uses of resources.
 - Customer satisfaction and loyalty is increased by providing personalized services.
 - Important in customer retention and enlarging customer base.

Q.7 Case Study

You are a manager of a rural branch of commercial bank. You are confronting with the problem of recovery of loan. What would you do to improve the recovery of loan and also explain legal course of action which you have with you as per present laws pertaining to recovery of dues.

Ans. In a rural branch of a commercial bank, loan may be broadly of two types:

- Loans for agricultural purpose
- Loans other than agricultural loans

For first category of loans, as a manager, we have to analyze the situation to find out reasons for non-repayment by the borrowers.. If non-repayment of such loan is due to crop failure because of drought or flood, govt.'s policy announcements will have to be examined. Maybe the govt. might have decided to re-phase the short term loans in to term loans and in such case, as

banker we will have to follow government instructions . There may be a situation where agricultural loans granted might have been covered under agricultural insurance scheme where insurance of crop is done and loss of crop is compensated by the insurance company. If it is so, a banker will have to get necessary papers prepared for getting compensation from insurance company.

If recoveries are low due to will ful default by loanees, the farmer wise position will have to be worked out and proceedings will have to be initiated based on the basis of loan documents executed. Bank can also give notices to the surities of loanees and in some cases; bank can get money from surities.

For heavy amount of loan, bank can initiate action under SARFAESI Act 2002, which empowers the bank to recover their NPA amount of loan without the intervention of court. Under this Act, bank can give 60 days' notice to the loanee after this notice period bank can take in its possession the security given for loan, sell the security and recover its money. If price received through sale is more than the amount due, balance amount can be refunded to the loanee. If amount is less, similar notice can be given to the surities of loanee.

Another alternative available to the banker is go for securitization of loan by selling such bad loans to asset reconstruction companies which are established only for this purpose.

If the recovery problem of loans is due to internal factors, bank will have to take some preventive measures so that situation remain under control. These measures may be as follows:

- Following proper credit assessment and risk management mechanism. For proper credit assessment, 5'C''s i.e. character, capacity, capital , collateral , conditions of borrower are to be critically examined. For overcoming risk, adequate security and margins are to be ensured.
- Organizational restructuring for follow up and recovery of loan will have to be undertaken.

After taking measure under preventive management bank may proceed curative measure and action under legal resources under various acts passed for this purpose such as

- Debt Recovery Tribunals
- Lok Adalats
- Asset Reconstruction Companies

- SARFAESI Act 2002



RTU QUESTION PAPER 2010
SUBJECT : BANKING SERVICES OPERATIONS (MINOR)

Q.1 What is confirmed irrevocable letter of credit? If you are a branch manager and you are approached by a customer to open a confirmed irrevocable letter of credit covering purchase of goods in London, what considerations would you take in to account for opening such a credit? What are the particulars which have to be communicated to your London agent.

Ans. A Letter for credit is a written undertaking issued by the buyer's bank (opening bank) to the seller to reimburse the cost of Goods and services supplied to the buyer by the seller against production of documents stipulated there in within a specified time at a specified place and up to the specified amount to a specified bank provided the document submitted are in strict conformity with the terms and conditions of LC. This LC may be revocable unless otherwise stated in credit. Irrevocable LC is a credit where all credits are irrevocable confirmed or unconfirmed. A confirmed LC is a credit where all credits are irrevocable unless otherwise stated in credit. Irrevocable LC cannot be cancelled or amended without the consent of beneficiary.

The bank which is confirming the credit is known as confirming bank. This confirmation guarantees the payment if the terms and conditions stipulated in the credit have been complied with.

As a branch manager of the opening bank issuing a letter of credit, the following considerations need to be kept in mind while issuing an irrevocable confirmed letter of credit.

1. Letter of credit should normally be opened on behalf of a regular customer covering genuine trading transactions.
2. Bank should open LC only after making proper enquiries with regard to antecedents of the borrower from the bankers with whom the parties are enjoying main limits.
3. Bank should make enquiry of financial position about the party / firm & their ability / capacity to retire the bill.
4. Bank should also prescribe a suitable margin and obtain other security as appropriate.

5. LC's should not be issued out of proportion to the borrowers genuine requirements.
6. LC's for acquisition fo capital goods should be opened only after bank has satisfied it self about tying up of funds for meeting the liability by way of providing for long term funds or term loans from financial institutions /banks.
7. Banks should in no case provide working capital limits to be allowed to be utilized for retiring bills pertaining to acquisition of capital assets.

The issuing banker should communicate following points to its London agents:

1. The limit of amount of LC and the total payable should not go beyond that amount.
2. The period during which LC will remain valid and the whole transaction should be completed during the period.
3. Specification of item to be sent to the buyer by supplying firm.
4. List of documents only complete to be sent by the London agent to the issuing bank in India e.g.
 - Original bill of exchange
 - Invoice
 - Insurance document as signed by insurance company or his agent .
 - Certificate about quality as per specification ordered
 - Transport documents e.g. bill of lading in case of a shipping company
 - Other documents as per terms of LC

Finally, buyer collects these documents from issuing banker after making payment and go to the shipping company to take delivery. The issuing banker in India remits the money to the paying banker and the whole transaction is over .

Q.2 “Reserve Bank of India is not only a controller of credit but also a promoter of credit.” Throw light on this statement with special emphasis on the latest credit policy of RBI.

Ans. In this statement given in the question, two aspects of RBI are to be discussed i.e. how RBI controls credit and how RBI is promoter of credit?

How RBI is controller of credit:

the RBI is Central Bank of Country and a bankers bank. It took over the function of management of currency from Govt. of India and power of credit

control from the them Imperial Bank of India . The following powers and measures of RBI prove that it is controller of Credit.

- The whole banking structure consisting of commercial as well cooperative banks is engaged in providing credit to needy individuals/ institutions and business organizations. This entire banking structure is controlled by RBI through.
 - Licensing
 - Branch expansion
 - Statutory inspection
 - Supervision & Control
 - Control over management & work through instructions & guidelines
 - Calling periodical returns/ statements

- The supply of money / credit is controlled through various measures like.
 - Increase / decrease in CRR, SLR, REPO, Reverse Repo Rates etc.
 - Rationing of credit
 - Prescribing margin requirements
 - Prescribing variable interest rates

Some of the measures are taken by RBI after undertaking quarterly review of economy.

How RBI acts as a promoter of credit:

Besides controlling RBI also promotes credit through different ways as given below:

1. RBI makes available credit to both Central & State Govts. to carry out its various developmental activities.
2. RBI makes money/ credit available to commercial banks through
 - Discounting / rediscounting of bills Govt. securities at Bank Rate.
 - Provides short term loans to commercial bank on rate known as REPO RATE.
 - Helps commercial banks to keep their surplus money with it at Reverse Repo Rate.

3. RBI play an active role in policy formulation for meeting credit needs of various key sectors of economy.
4. RBI also extends help to various developmental financing Institutions like NABARD, National Housing Bank etc. In fact NABARD come into being by taking over RBI responsibilities of providing credit for agricultural and rural development.

From the above, it is quite clear that RBI works as a controller and promoter of credit.

Latest Credit Policy of RBI:

Both the aspects of RBI's working i.e. controller and promoter of credit are also reflected in the latest credit policy of RBI. The credit policy of RBI is in tune with the broad objectives of economic policy of Govt. of India which aims at increasing GDP rate as per increasing per capita income and converting the economy from developing to a developed economy. General economic objectives of such policy are:

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

In tune with above, following are the key objectives of current credit policy announced by RBI.

- To encourage savings and mobilize savings for capital formation and development
- Supply of adequate credit to meet increasing demand of agricultural, industry, trade commerce and other productive activities so that overall economic development is ensured.
- To encourage development without financial hindrance.
- To control inflation pressure and maintain price stability.

In the latest policy measures announced by RBI were for controlling inflationary trends for which RBI made upward revision in CRR rates from 5.75% to 6% and through this measure

alone, RBI expected that around Rs. 12500 crores would come from banks to RBI which would have a positive impact on controlling inflation which is a biggest challenge faced by Indian Economy. Similarly, repo & reverse repo rates have been revised many times during 2010-11.

Q.3 Please state about:

- a) **Main difference between the statutory liquid ratio and cash reserve ratio.**
- b) **Control of RBI on activities of Commercial banks.**
- c) **Nature of Commercial Banks.**

Ans.

a) Cash Reverse Ratio (CRR)

It is the ratio of cash reverse required to be maintained by commercial banks in relation to their total time and demand limitation (TDL) with Reserve Bank of India as per section 42 of RBI Act 1934. Presently, this rate of CRR is 6% effective from 24.04.2010 as announced by RBI in its quarterly review made on 24.04.2010.

Besides this CRR each bank has to make investment @25% in the form of Statutory Liquidity Ratio(SLR) in approved securities as per section 24 of Banking Regulation Act 1949.

While CRR remains with RBI, SLR is a investment required to be made in Govt. and Govt. approved securities. Due to this provision of SLR, Govt. and Govt. Organizations get money from banking institutions.

b) Control of RBI on activities of commercial banks

The RBI Act 1934 and Banking Regulation Act 1949 have given wide powers to RBI to exercise control on the activities of commercial banks. The Key activities / powers through which RBI exercises control are as under:

- I. Control through the power of licensing over commercial banks and cooperative bank. Without getting license from RBI, no bank can start business of banking in India.
- II. Branch Expansion : Opening & Closing of branches is again regulated by RBI, for opening a branch as well as for closing a branch, RBI's permission / approval is required.

- III. Liquidity: Each commercial bank has to follow liquidity norms as prescribed by RBI in the form of CRR and SLR. While CRR is to be kept with RBI as per rate prescribed, SLR is investment to be made by a commercial bank in Govt. and Govt. approved securities as per rate prescribed by RBI in relation to their total time and demand liability (TDL). Failure to maintain such prescribed liquidity, a commercial bank would attract penalties which may be imposed by RBI.
 - IV. Management and method of working- like amalgamation, reconstruction and liquidation are to be resorted to with the approval of RBI.
 - V. Statutory Inspection: RBI is empowered to undertake statutory inspection of commercial banks as well as all banks are required to send compliance report of such inspection to Reserve Bank of India.
 - VI. Statutory Returns/ Statements- the RBI also exercises control over the working of commercial banks through calling, periodical statutory returns / statements and based on the information collected through these returns, RBI analyses the financial position and offer comments for bringing required improvements in areas considered wanting by RBI.
 - VII. Power of issuing directions / guidelines- Besides above, RBI has wide powers to issue direction and guidelines which are required to be followed by bank in the interest of depositor.
- c) Nature of Commercial Bank
In the banking sector RBI act as a central bank of the country and bankers bank. Under RBI, the whole structure of bank in India can be broadly classified in two parts i.e.
- I. Commercial Banks
 - II. Cooperative Banks
- Commercial banks can be further classified in to three i.e.
- I. Public Sector Banks
 - II. Private Sector Banks
 - III. Foreign Banks

Public Sector Banks are those where ownership of Govt. is more than 50%. They are also known as Govt. Banks. These banks can also be divided into following three categories.

- i. **Nationalized Banks-** 14 banks were nationalized in 1969 and 6 more banks were nationalized subsequently. In all these banks Govt. ownership is more than 51% and hence they are known as Govt. of India undertakings.
- ii. **SBI Group ie.** State Bank of India and its subsidiaries – State Bank of India was nationalized in 1955 which was earlier known as imperial Bank of India. Six more subsidiaries of SBI were formed subsequently like State Bank of Indore, State Bank of Bikaner & Jaipur, State Bank of Travankore & Kochin etc.
- iii. **Regional Rural Banks-** These banks were created after passing RRB Act'1974 to supplement the efforts of cooperative credit institutions to meet the demand of credit in rural areas and to provide them banking facilities.
- III. **Private Sector Banks-** In India we have large number of Private Sector Banks. Prominent banks in this sector are ICICI Bank , HDFC Bank, Kotak Mahindra Bank etc.
- IV. **Foreign Banks-** We have many foreign banks like ABN Amro, American Express, Standard Chartered Bank etc.

Q.4 "A customer approaches his banker for a loan of Rs. 7 lakhs and is prepared to submit any one of the following as security.

- I. A Palace costing of Rs. 9 Lakhs
- II. A LIC Policy costing of Rs. 10 Lakhs
- III. Partly paid up shares of a joint stock company worth Rs. 12 Lakhs
- IV. 20000 ordinary shares of a cotton mill quoted at Rs. 70 (face value of Rs. 10)

Which security banker should accept and why?

Ans. Out of 4 above securities offered," bank should accept security No. 1, i.e. A palace costing Rs.9 lakhs. Though the word "Palace" has been used here, it is presumed that it is a small beautiful house which has costed Rs. 9 lakhs to its owner including cost of land. Though margin to the banker is not adequate but it is presumed that market price of this palace may be much more than 9 lakhs .Moreover in present day scenario the value of house property is increasing at a fast rate even in small towns / cities . Such appreciation in the value of house property in big cities and metro cities is increasing at a much faster rate. Hence there seems to be no risk in providing a loan of Rs. 7 lakhs against this house /palace after verifying title deeds. However bank as a routine procedure would like to ensure the insurance of house & two securities etc.

Other three options can be rejected due to risk factor as ,mentioned against each below.

A LIC Policy costing of Rs. 10 Lakhs: - It is not clear as to how many years the policy has already run and premiums were regularly paid or not. If payment of premium is stopped, than LIC only pays surrender value of the policy and amount paid as surrender value would be much less.

Partly paid up shares of a joint stock company worth Rs. 12 Lakhs:-

Here it is not clear as what amount in percentage of a share value has been partly paid. If the remaining amount of share value is not paid when demanded by the company the part payment made earlier is likely to be forfeited and hence there is a heavy risk in this security.

20000 ordinary shares of a cotton mill quoted at Rs. 70 (face value of Rs. 10)

Here, the total face value of 20000 shares @ face value of Rs. 10 comes to only Rs. 2 lakh. Further these shares are of a cotton mills which in these days are mostly in crisis. Though shares have been quoted at Rs. 70 each and with such quote , the total value of shares comes to Rs. 14 lakhs but there is a heavy risk of share prices coming down. Many

banks have already burnt their fingers in such deals due to crash of prices in share market and hence, bank should not take such risk.

As stated above, option number one seems to be most safe as compared to other three and bank should accept item 1 as security for advancing a loan of Rs. 7 lakh.

- Q.5 Explain the following (any seven)**
- I. NRE Account and ICMR Account**
 - II. RTGS**
 - III. Microfinance and Consortium finance**
 - IV. NPA's**
 - V. Bank Assurance**
 - VI. Asset Liability Management**
 - VII. RRB's**
 - VIII. Multiple Banking Arrangements**

Ans NRE & FCNR Account

Non Resident External (NRE) account can be opened by a non-resident individual of Indian nationality or origin. Only remittance received in permitted foreign currency from abroad can be credited to NRE account. The interest earned in NRE account is exempt from income tax. The foreign currency Non-Resident Account (FCNR) can also be opened as NRE account. But in these accounts are maintained in designated foreign currencies. At present, authorized dealers in foreign exchange can open FCNR account in four currencies i.e.US Dollar, Pound, Sterling, Euro & Japanese yen. These accounts can be in the form of term deposits only.

RTGS- Real Time Gross Settlement (RTGS) system is an important milestone in Indian Banking System through which high value cheques (cheques Rs. 1 lakh and above) are settled and amount is credited in customers account on the same day. This settlement of accounts between two banks takes place through RBI. Each participant bank of RTGS will be required to open a dedicated settlement account with RBI for putting through RTGS settlements. In this system, electronic message is sent to another banker through RBI Mumbai and account is

settled within 4 hours. Even money transfer transaction as well as foreign exchange transaction between Indian bank as a foreign bank can be settled through RTGS system.

Microfinance and consortium finance

Micro-finance has been defined by RBI “as provision of thrift, credit and other financials of very small amount to the poor in rural, semi urban and urban areas to improve their income and living standard.”

Non-Governmental organizations (NGO's) voluntary organizations and self help groups (SHG's) are playing important role in providing microfinance facilities. Even NABARD is playing active role in supporting micro finance institutions.

In consortium finance several banks finance a single borrower with a common appraisal common documentation joint supervision and follow up exercise. When credit requirements of a unit are large, two or more banks / financial institutions join together and provide the required credit facility. In big projects institutions like IDBI, IFCI, & ICICI operate a system of consortium finance through a common project appraisal.

NPA's

A balance sheet of a bank has performing and non-performing assets. Performing assets are those on which interest and principal is received when due. Non-performing assets(NPA's) are those on which interest and principal are not received within 90 days from the date they become due. The RBI has taken a policy decision that if interest and principal is not received within 90 days from the date it become due, it is to be treated as NPA and banks can't show the interest income as receivable and cannot credit the same in their profit & loss account.

These NPA's are classified in to:

Sub standard assets

Doubtful assets

Loss assets

Provision for NPA's is required to be made as per norms/ guidelines as prescribed by RBI.

Bank Assurance

Bank assurance means distribution of insurance products through the distribution channel of banks. It is also known as “All finaaz” and constitutes a 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 motive behind bank assurance for a bank are product diversification and generating additional income. For an insurance company, motives of bank assurance are increasing their market penetration, increasing premium turnover, reducing initial costs of selling and making use of wide network of banks for selling their products. For a customer, motives of bank Assurance are products at a reduced prices, product of high quality and product at a single point/doorstep.

Asset Liability Management (ALM)

ALM is a systematic process to maintain proper match in maturity timings so that at no time there is risk of liquidity without adversely effecting profitability of the bank. Assets of banks mainly constitute loans and advances, investments. Similarly liabilities mainly constitute current/saving deposits. Fixed deposits call deposits etc. ALM ensures deployment of funds in loan & advance and investments in such manner so that adequate liquidity is always available to pay off the liabilities. Three important aspects of ALM are:

- Cash management
- Liquidity Management
- Interest rate risk management

In banks ALM committee is formed consisting of senior executives to look after these crucial aspects.

Regional Rural Bank (RRB's)

One of the key points under the 20-point Economic Programme during emergency was “provision of cheap credit for marginal farmers, landless labourers, artisans in rural areas and liquidation of rural indebtedness in stages.” To implement this, GOI came up with the idea to set up RRB's and hence the RRB Act was passed in 1974. These RRB's were

started in 1975 to supplement the efforts of rural credit cooperatives in rural areas.

The broad objective with which RRB's came in to 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 particularly to small and marginal farmers, agricultural labourers, artisans and small entrepreneurs.

RRB's are joint ventures of central govt, state govt., and sponsored bank with a share capital contribution of 50% ,15% and 35% respectively. The NABARD at the national level provides finance to these banks and monitors their working.

Multiple Banking Arrangements -

Where the credit requirement of a borrower are met by more than one bank and each bank lends independently on its own terms and conditions regarding the security, rate of interest, margin etc. this system of financing is called multiple banking arrangements.

It is like consortium arrangements. In order to ensure that the arrangement works well, finance is not on the higher side, finance provided is likely to come back with interest when due, it is necessary that banks must exchange from time to time. True and frank information in respect of borrower, his account or dealings. In this arrangement banks are independent of each other in respect of documentation, monitoring and conduct of account.

Q.6 What do you understand by term discounting of bills of exchange? Why does a banker invests his funds in them? Also state the difference between " bill purchased" and bill discounting."

Ans When buyer does not have ready money to pay to the seller, he requests seller to write a bill of exchange on him and buyer accepts the same and return it to seller. Now seller has two options i.e. either wait for the period mentioned in bill for getting payment from buyer or approach a bank for getting it discounted if the seller is in need of money. In such a situation, bank discounts the bill and make payment to seller after

deducting discount. The buyer is informed who on maturity makes payment to the banker instead of seller. This process is known as discounting of bill of exchange.

For a bank, there is no hitch in discounting the bill as bank gets discount and is almost certain to get money from the buyer on maturity as it is a genuine trade transaction through a bill of exchange which is negotiable instrument under negotiable instrument Act. In addition to bill of exchange to a reputed buyer who would by all means likely to make payment on maturity. Hence, banks found no risk in making such instrument in discounting bills of exchange.

As regard part 3rd of question, the term bill purchases is not a common term used in business since a bill of exchange is a negotiable instrument , it can be negotiated through endorsement and the person to whom it is endorsed get the right to receive payment form the acceptor of bill i.e. original buyer. This process of getting the bill through endorsement can be called as bill purchased. Bill discounting is a separate process where seller discounts it from banker as explained in part one of the answer.

Q.7 When considering a proposal for advance to a limited company, a banker has to study previous and latest balance sheet of the company and in that connection following are some of the items which come up for examination.

Explain each of these items with special reference to its significance to the lending banker giving hypothetical examples to simplify your answer.

- I. Net Worth
- II. Book debts
- III. Current Ratio
- IV. Intangible Assets
- V. Debt- Equity Ratio

Ans Net Worth

Net worth or owners fund include the amount owned by a form which includes paid up share capital (equity as well as preference share capital) reserves created amount of profits, surplus of profit less accumulated loss if any. This sum total will be net worth of a form or

share holders fund in a firm. While advancing loans, banks generally calculates net worth of a firm and sanctions loans keeping in view total net worth of a organization / firm.

Book debts

Book debts is one of the key assets in the asset side of balance sheet. All the debts should be realizable and no amount should be of the nature of bad debt. Hence, detailed analyses of this item need to be made to find out amount of debts coming in NPA category, classification of NPA in to sub standard, doubtful and loss asset and provision made for such NPA's and shown in balance sheet. If all book debts are current debts and no amount of debt is likely to become bad debts, it is indicator of good financial position of the firm.

Current Ratio

It is a measure of studying the liquidity of a firm. It is calculated as follows:

$$\text{Current Ratio} = \frac{\text{Total Current Assets}}{\text{Total Current Liabilities}}$$

Current Ratio tells/ indicates firm's ability to pay its current liabilities out of its current assets. If the firms current assets are Rs. 500000/- and current liabilities are Rs. 2,00,000/- this ratio would be Rs. 500000/- / 200000/- i.e. 2:5. It means that current assets of a firm are 2.5 times of current liabilities.

Generally standard current ratio is 2:1 which is considered satisfactory. In above example is more than this which shows firms good financial position as its current assets are not double but 2.5 times (more than double) of current liabilities.

Intangible Assets

Intangible assets are those assets which are not tangible or visible and it is very difficult to verify and value them. Examples of such assets are goodwill, patent, brand etc. it is very difficult to verify such assets and also valuation of such assets is also difficult. However such assets exists

in balance sheet as one firm might have purchased another running business and might have paid substantial amount on buying such assets.

Debt Equity Ratio:

This ratio is used to measure the indebtedness of a firm. It is calculated by comparing long term debt with total share holder's fund:

$$\text{Debt Equity Ratio} = \frac{\text{Debt}}{\text{Net Worth Holders Fund}} \quad \text{Or} \quad \frac{\text{Total Long Term}}{\text{Total Share}}$$

Where the long term debt include long term loan, borrowings, debentures and share holders fund include equity share capital , preference share capital all accumulated reserve and surplus.

For example, equity share capital is 15,00,000/- preferences share capital is Rs. 5,00,000/- reserves are Rs. 25,00,000/- debt is Rs. 70,00,000/-

$$\text{Debt Equity Ratio} = \frac{\text{Rs. 70,00,000}}{\text{Rs.15,00,000+Rs. 5,00,000+Rs. 25,00,000}}$$

$$\text{Debt Equity Ratio} = \frac{\text{Rs. 70,00,000}}{\text{Rs.45, 00,000}} = \text{i.e. 1.55}$$

It means that form has taken long term debt to the extent of 1.55 times of share holders fund.

RTU QUESTION PAPER 2011
SUBJECT : BANKING SERVICES OPERATION (Major)

Question 1 Write short note on the followings :

- (i) **Unit Banking** (ii) **Regional Rural Banks**
(iii) **Bank assurance** (iv) **Universal Banking**

Answer

(i) Unit Banking : Unit banking refers to a single bank which renders services and operates without any branches any where. Unit banking system is not found in India in respect of commercial bank but it is very common in U.S.A. However there are a few banks in urban cooperative banking sector, which work as unit bank. These urban cooperative banks are at small Towns/Tehsil level places and operate without any branch.

(ii) Regional Rural Banks (RRB'S) : In order to implement 20 point economic programme of Govt. of India, Govt. came up with the idea to set up RRB's and for this RRB Act was passed in 1974. These RRB's were started in 1975 to supplement the efforts of rural credit cooperatives in rural areas.

Broad objectives with which RRB'S came in to being were as follows .

To develop rural economy by providing financial assistance to:

- Agriculture
- Trade commerce industry and productive activities in rural areas
- Providing credit particularly to
 - Small and original farmers
 - Agricultural labor
 - Artisans and small entrepreneurs

RRB'S are joint ventures of central govt., state govt. and sponsored bank with a share capital contribution of 50%, 15% & 35% respectively.

RRB'S are expected to prepare production plans in its area village-wise and block-wise. They are permitted to attract deposits @ ½% more than rates of commercial banks and their lending rates are kept at par with rates of village cooperative societies. Sponsored bank used to provide managerial and Financial assistance to these banks.

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

(iii) Bank Assurance : Means distribution of insurance products through the distribution channel of banks. It is also called “All Finance” and constitute package of financial services that can fulfill both banking and insurance needs at the same place and time. It is packaged services of banking and insurance afford to customers at one place, under one roof and at one time. The motives behind it are :

For a bank :

- Product diversification
- Generating additional income

For a Insurance Company

- Increasing their market penetration & share
- Increase in premium turn over
- Reducing initial cost of selling
- Making use of wide net work of banks for selling their products

For customers

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

(iv) Universal Banking : A universal banking is a one stop shop which deals with a wide portfolio of financial products integrating :

- Project financing
- Commercial banking
- Investment banking
- Term lending
- Retail operations
- Mutual funds
- Pansion funds
- Underwriting of securities
- Insurance

This concept is more relevant in UK & USA where distinction between investment bank and commercial banks was largely removed and

banks were working as banks providing both commercial banking & investment banking services to its customers.

Question 2 Sub-prime crises of 2008 had adverse impact on all the economies of world. Central Government of each country initialed steps to minis the impact on the economic condition of the country. Discuss the steps taken by RBI to safe guard Indian Banking Industry.

Answer : It is very correct that the economic crises of 2008 which was a world wise phenomenon effected economics of most of the countries including India. Some of the major effects on Indian economy were :

- 1- Liquidity crises with individuals, business, trade and industry
- 2- Reduction in production of goods and services in different sectors.
- 3- Job cuts/pay cuts in some of the industries and even in public sector undertakings
- 4- Real-estate market prices heavily by came down
- 5- Pressure on banks for providing loans and advances increased
- 6- Many new cases of dishonor of checks under Negotiable Instrument Act came in to light due to liquidity crises and pressure of creditors on debtors.
- 7- Problem of unemployment and under-employment became more critical
- 8- Due to shortage of goods, prices shown increasing trend.

To overcome above problems, central bank of the country i.e. RBI initiated various measures to save Indian banking industry.

- 1- Cash reserve ratio : was reduced to ensure increase in loanable resources of bank. In May, 2008 CRR was 8.25 which was reduced. Since last two years it is only 6%
- 2- Repo rate : remained quite low facilitating commercials banks to make short term borrowings from RBI
- 3- Bank rate was reduced from 7% to 6% facilitating discounting facilities by commercial banks from RBI
- 4- Terms and conditions for different types of loans from commercial banks were liberalized by RBI to ensure greater money supply in the market.

Besides RBI, Govt. of India also came up with relief package for trade and industry including revival of sick units. Even package was announced for those exporters who had to bear loss in export trade due to fluctuations in currency rates.

Now RBI's greatest challenge is to control inflation which went to more than 20% in May 2010. RBI has made upward revision in repo and reverse repo rates 8 times in 2010-11 However, inflation continues to be great challenge before RBI even today.

Question 3 Explain the term "Cross Border Banking" and method of finance in international trade.

Answer : Cross Border Banking : The banking system of some countries provide export intermediation services to the rest of the world, while many other countries are net exporters of deposits to banks abroad and net importers of loans from banks aboard. Banking centre countries typically has lower inflation, deeper financial systems , earn less govt. revenue for seignior rage, and have lower money relative to bank assets than non-banking center countries. Monetary policy takes the form of controlling supply of reserve money and imposing restrictions on banks that generate demand for reserve money. The international competitiveness of banking system is enhanced by having a monetary authority who places greater weight on interest of existing creditors relative to debtors in its constituency, and who has less need to raise revenues from seignior age. With complete integration of deposit and loan market the location of intermediation can be indeterminate. Countries that receive more deposits can generate a given amount of seignior age with less inflation . Monetary authorities in countries that experience deposit outflows may be tempted to impose capital controls in order to maintain their seignior rage base. One implication of the analysis is that integration of monetary policies can facilitate financial integration by reducing the incentive to relocate deposits to avoid the inflation tax.

Methods of financing international trade

There are 5 methods of financial international trade

- Prepayment
- Letter of credit
- Draft

- Consignment
- Open account

Question 4 Describe the concept of Capital Adequacy (CAR) for banks in India and methodology for computation for the same. Give example using data

Answer : This capital adequacy ratio (CAR) is also known as capital to risk asset ratio (CRAR) It is the ratio of capital fund to risk weighted assets. It was introduced on commercial banks around 15 years back by RBI to enable the bank to strengthen its risk bearing capacity through its capital fund.

Capital fund consists of two broad groups i.e. Tier I and Tier II.

Tier I : Capital which is known as core capital provides most permanent and readily available support to bank against expected losses. This tier I consists of

- Paid up share capital
- Free reserves
- Capital reserve &
- surplus of profit (undistributed)

Tier II : Capital consists of elements that are less readily available to meet expected losses. This tier II includes items like

- Undisclosed reserve
- Re-valuation reserve
- Hybrid debt capital instruments
- subordinate debt

Risk Weighted Assets : Means weighted aggregate of funded and non-funded items. Such risk weights allotted to all items of assets are prescribed by RBI and these risk weight are subject to change as per announcement made by RBI. Accept a few items like cash in hand, cash with RBI, most of items have risk weights prescribed by RBI. The total of that item of asset is added by percentage of risk weight. For example risk weight on building is 100% and the amount of building is Rs. 10 lakhs, its risk weight value for CAR would be Rs. 10 lakhs. In a similar way aggregate value of risk weighted assets are worked out and finally ratio of capital fund to risk weighted assets is calculated.

For example :

Total capital fund
 Consisting of Tier I and
 Tier II is Rs. Rs. 10 Lakhs
 Aggregate value of
 Risk weighted asset are Rs. 1 Crore

CAR comes to 10%. Presently minimum CAR prescribed by RBI is 9% .
 If it goes below 9%, it would be violation of RBI in relation to risk
 bearing capacity of bank. Hence it should always be more than 9%.
 This CAR or CRAR represents the percentage of bank own capital
 funds in relation to risk weighted assets i.e. adequacy of capital fund in
 relation to risk weighted assets.

Question5 Describe methodology and type of E-banking. Describe various kinds of services covered under it. Also explain the role of E-banking in E-commerce.

Answer: Also known as internet banking, E-banking means any user with a personal computer can get connected to his banks website to perform any of the banking functions. In it, a bank has a centralized data base that is web enabled. All the services that the bank has permitted on the internet are displayed in the menu and a customer can avail these services through his P.C.

Objects of E-banking

- To provide services in users own environment for convenience and accessibility
- To reduce risk of cash handling
- To provide services at lowest cost
- To provide system that delivers efficient payment linked to a bank account.

E-banking has at least following dimensions

- Customer to bank e-banking
- Bank to bank e-banking
- Electronic control banking
- Internet procurement

One can avail following services through e-banking

- Bill Payment Service : Banks have tie up with utility companies e.g. electricity, telephone, insurance and

payment to such companies can be made by customer through e-banking or standing instructions to banks for making such payments.

- Fund transfer : from one account to other or from one bank to other
- Railway passes on line
- Investing through internet
- Re-charging your prepaid phones
- Shopping and purchase of rail/air tickets.

E-commerce : Electronic commerce commonly known as e-commerce consists of buying and selling of products and services over electronic system such as internet or other computer net work. The amount of trade conducted electronically has grown extraordinarily since the spread of internet.

A wide variety of commercial activities are conducted through internet such as

- Electronic fund transfer
- Supply chain management
- Internet marketing
- On line transaction processing
- Electronic data interchange
- Inventory management systems
- Automatic data collection systems

This e-commerce services can be availed due to e-banking (internet banking) . Hence it can be concluded that e-banking has enabled e-commerce and enabled growth of business and trade by customers in their own environment at convenience.

- Q.6 Zip-Zap Ltd. Sells goods on credit. Its current annual sales is Rs. 900 lakhs. The variable cost to sales ratio is 80%. The credit terms are "2/10 net 30". At present bad debts are 0.75%. The past experience shows that 50% of the customers avail cash discount of 10% and remaining make the payment in 50 days time. Company finances its book debts in the ratio of 2:1 by a mix of bank finance and equity capital. The cost of bank finance is 25% p.a. and cost of equity is 28% p.a.**

Zip-Zap Ltd. Is one of the important clients of Zupiter Bank. You are newly recruited Financial Consultant to Zupiter Bank. Bank has recently started fee based service namely "Factoring Services". For Important clients like Zip-Zap bank is willing to grant full factoring service which will suit the requirement of Zip-Zap. Being an expert in banking services operations design suitable factoring service for the client. Make necessary assumptions.

Ans. Being a financial consultant we have two options.

1. In house management
2. Factoring

Assumption is that factoring is non-recourse with commission say (4%), factor reserve (15%), data collection period = 30 days.

1. In house management alternative

Particular	Amount (Lakhs)
Cash Discount (Rs. 900 Lakhs \times 0.5 \times 0.02)	9.00
Bad Debts (Rs. 900 \times 0.75/100)	6.75
Investment Cost (From working note 1)	19.50
Total Rs.	35.25

2. Factoring Alternative

Commission (900 \times 0.4 Lakhs)	36 Lakhs
Cost of owned fund invested in receivable [(900-734.4 Lakhs) \times 0.28 \times .30 / 360] (from working note II)	3.86 Lakhs
Total Cost of factoring	39.86 Lakhs

Working Note : I

Calculation of Investment in Receivables.

$$\left(\frac{\text{Credit Sales}}{360} \times \text{ACP} \right)$$

$$= (900/360 \times 30 \text{ days}) = \text{Rs. 75 Lakhs}$$

Where ACP = Average Collection Period
 $= [10 \text{ days} \times 0.5] + [50 \text{ days} \times 0.5]$
 $= 30 \text{ days}$

Cost of bank fund = (Rs. 75 Lakhs \times 2/3 \times 0.25) = Rs. 12.5 Lakhs

Cost of owned fund = (Rs. 75 Lakhs \times 1/3 \times 0.28) = Rs. 7 Lakhs

Total cost fo fund = [Rs. 12.5 Lakhs + Rs. 7 Lakhs] = Rs. 19.5 Lakhs

Working Note II

(2) Commission = 4% of 900 Lakhs = $900 \times 4 / 100 = 36 \text{ Lakhs}$

Since commission in payable in advance. It is reduced from actual payment.

Amt. after commission = $(900-36) = 864$ Lakhs
 Amt. payable by factor = 85% of 864 Lakhs = 734.40 Lakhs

Question 7 RBI has implemented prudential norms for each and every bank working in India. One of the prudential norm is about NPA. From the following data calculate the amount of provision for NPA. Total Loan Portfolio of bank is Rs. 300 crore. Out of this 70 crore is the loan which has been given during last 90 days. Another fact is that only $\frac{1}{3}$ of this loan which has been given during last 90 days has sufficient collateral assets. Interest and principal amount is overdue for the loan portfolio value of 20%. This is overdue for last 12 months. On another 30% of the total loan portfolio interest and principal is overdue for more than 12 months but less than 24 months on another 5%, there is no change of recovery. Being a banker calculate the amount of NPA provision which your bank must maintain.

Answer : The details of NPA advance in this case are worked out as under

Total advances portfolio	Rs. 300 crores
out of which advances	
made only 90 day before	Rs. 70 crores

Hence total loan which may become NPA comes to Rs. 230 crores
 As per information given in the case 20% of loan is overdue for last 12 months.

Hence substandard advances comes to Rs. 46 crores

Doubtful assets @ 30% of Rs. 230 crores to

Rs. 69 crores

Loss asset @ 5% of Rs. 230 crores

Comes to Rs. 11.5 crores

Hence total NPA provision would be as follows.

1- Sub stand advance of Rs. 46 crores @ 15% Rs. 6.9 crores

2- Doubtful asset of Rs.69 crores @ 40% Rs. 27.6 crores

3- Loss assets of 5% of 230 crores

i.e. Rs. 11.50 crores @ 100% Rs. 11.5 crores

Total NPA provision	Rs. 46.00 crores
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Above provisioning has been made as per latest and revised rates prescribed by RBI.



RTU QUESTION PAPER 2011
SUBJECT : BANKING SERVICES OPERATION (MINOR)

Question 1 : Discuss the fractional reserve system of modern banking. Discuss the important trends in India's credit policy over last 5 years.

Answer : It is a banking system in which only a fraction of bank deposits is backed by actual cash on hand and are available for withdrawal. This is done to expand the economy by freeing up capital that can be loaned out to other parties. It is a type of banking where depositors invest their base money in a bank and have the ability to earn interest. The bank takes over the ownership of base money entering in the bank, uses it to maintain high liquid reserves to pay expected customer withdrawals and pay for bank operations, and in return gives the customer a credit to their account which the bank ensures the customer can use as money to buy goods and services any where in the economy. This system of fractional reserve is followed in most of the countries.

In India, as per RBI Act 1934, cash reserve ratio @ from 3% to 15% can be fixed by RBI. Presently this cash reserve ratio is 6% which is required to be deposited with RBI by banks in India. Beyond this 6% which goes to RBI, banks are maintaining another 2% or 3% cash for meeting day to day deposit claims of customers. In case of run on bank, RBI comes to the rescue of that bank and helps the bank to come out of this run.

However, in case of run on bank, a bank can also raise funds from additional borrowings by way of short term loans and borrowing from money market.

CREDIT POLICY

Monetary and credit policy is the process by which the Govt., Central Bank or Monetary Authority of a country controls.

- Supply of money
- Availability of money
- Cost of money or rate of interest

in order to attain a set of objectives oriented towards growth and stability of the economy. Under this policy, central bank of the country make use of instrument to regulate money supply and bank credit to influence level of aggregate demand of goods and services. In India

RBI as central bank of the country is announcing monetary and credit policy. Since last 5 years, the main objectives of India's monetary and credit policy remained as follows :

- Price stabilization
- Exchange rate stability
- Full employment
- Economic growth

During last two years, the prime aim of this policy at the level of RBI has been controlling inflation which in May 2010 went up to 21%. To overcome this problem of inflation RBI revised its two key rates i.e. repo rate and reverse repo rate. These rates were revised 8 times in 2010-11 and again in first 3 months of 2011-12, these rates were revised. Hence during last 16 months, both these rates were revised 10 times. The result of these measures have shown results and this inflation rate came down to around 9% in May 2011. This 9% is still considered high and RBI is keeping close eyes to further reduce this inflation rate in times to come. Earlier RBI used to undertake quarterly review of economy but now, it has started even mid quarterly review to have strict control on the economy. As a result such review is undertaken 8 times and suitable measures are announced by RBI in this regard.

Question 2 : Critically examine the growth of Retail Banking in India. What has been the important challenges faced by private sector and foreign banks with respect to retail banking in India?

Answer : Retail banking refers to banking in which banking institutions execute transactions directly with customers rather than corporations and other banks. It is a typical mass market banking where individual customers use local branches for various services.

Various products in retail banking

1. Liability products : Different types of deposits such as saving, current, fixed/term, recurring and no-frill deposit amounts.
2. Asset products : Different types of loans such as housing, personal, education, gold,

mortgage, vehicle and agricultural loans.

3. Credit & Debit card facilities.
4. Investment products like insurance, mutual fund pension plans etc.

With constant diversification and innovation in products and services, retail banking business has grown to a enormous size. The policy of financial inclusion announced by govt. of India has given a further flip to the growth of retail business by commercial and cooperative banks in India. Banks are improving their quality and services, trying to provide services more quickly resorted to new delivery channels, tie up arrangements and business process out-sourcing due to which retail business is increasing at a faster rate.

Challenges in Retail Banking

Inspite of huge growth retail banking particularly in ease of private sector banks and foreign banks is facing following challenges

- (i) Customer relationship : Due to high degree of competition, retaining retail customers is a big challenge.
- (ii) Technological barriers : The increasing use of ATM'S and e-banking has created lot of technological strains on banks and lot of security related problems have started working in.
- (iii) KYC Norms and Regulatory Compliance : Banks are required to follow strict know your customer (KYC) norms prescribed by RBI.
- (iv) Customer Information Sharing : amongst banks is also a difficult task faced by banks in retail sector. It is difficult to know good track record of customers.
- (v) Lack of Proper Credit Evaluation and Scoring System : Financial statement and audited statements are generally not available with retail banking customers and in such a situation bank has to depend on character of borrower, his sources of income, purpose of loan etc which is not full proof system of appraisal for credit.
- (vi) Recovery : Due to reasons explained in point V above, the risk in recovery is high. Due to high risk, RBI has increased risk weight in case of consumer loan, person loans, credit cards.

Such risk weight on this type of credit is ranging from 100% to 125%.

In spite of some problems given above, private sector banks retail business is increasing. Amongst private sector banks, ICICI has become the largest private sector bank and is much ahead from other private sector banks because of its innovative products and services in the retail sector.

Question 3 Describe the rationale behind the setting of rural development banks while examining their contribution in the growth of the rural economy. How is micro-finance helping in bringing the benefits of modern banking to the rural poor?

Answer : In the field of rural credit/rural finance & rural development, cooperative credit agencies in India are working since 1904. However, to supplement the efforts of cooperatives, Regional Rural Banks (RRBs) were specially started after passing the RRB Act 1974. Since 1975, many RRBs are working for rural development. Besides RRBs and cooperatives, the Govt. of India took a decision and also compelled commercial banks to start rural/agricultural finance and set up a target in percentage of their total advances for agricultural/rural finance.

However, at the national level a separate bank in the name of National Bank for Agricultural and Rural Development (NABARD) was set up in 1982 under the NABARD Act 1981 on the recommendation of the committee to Review Arrangements for Institutional Credit for Agriculture & Rural Development (CRAFICARD) constituted by RBI. It was created by taking over the functions of the Agriculture Credit Dept. of RBI, Rural Planning & credit cell of RBI and Agriculture Refinancing and Development Corporation. It was created as an apex institution at the national level with all matters concerning policy, planning and operations in the field of credit for agriculture and other economic activities in rural areas. It was established as a development bank to look after the entire agricultural credit and rural development at the national level so that adequate attention could be paid by it on agriculture and rural development in India. It aims at providing and regulating credit and other facilities :

- For promotion and development of agriculture

- Small scale industries
- Handicraft and other rural craft
- Cottage and village industries
- and other allied activities

to ensure integrated rural development and securing prosperity of rural areas. Hence the key rationale behind setting up NABARD was to ensure all sided development of rural areas as a development bank for agriculture and rural upliftment.

Micro-finance

Micro - finance refers to provision of financial services to poor or low income clients in rural, semi urban and urban areas including consumers and self employed. It refers to “ a world in which as many poor and near poor households as possible have permanent access to an appropriate range of high quality financial services including not just credit but also savings, insurance and fund transfer.” The main aim of micro-finance institution is to help poor people to come out of poverty. Key micro-finance products are :

1. Micro-savings : Self Help Groups (SHG'S) are best examples of Micro-finance institutions which inculcate habit of savings in members
2. Micro-loans : Out of the pooled savings, needy people are provided loans for starting small business to earn livelihood.
3. Micro-insurance : insurance for life and property is provided by insurance companies to members of SHG'S.
4. Micro-leasing : leasing of agricultural machinery, equipment, vehicles to poor on nominal rent/lease to carryout business for generating income
5. Micro-fund transfer : of poor people to their nears/relatives in the country and abroad through commercial banks at nominal costs.

In the field of micro finance, financial institutions like agricultural development banks, saving banks, rural banks and non-banking financial institutions are providing funds to poor. In the whole world, leading micro-finance institution is Grameen Bank of Bangladesh which serves more than 2.4 million clients out of which 94% are women.

In India many NGO'S are working in this field and many SHG'S are operating in rural and urban areas extending facilities of savings (deposits), loans out of pooled funds, insurance facilities as well as transfer of funds.

Hence micro finance institutions are bringing benefits banking services to rural poor in India.

Question 4 'Public sector banks have settled about 30% of the NPA cases for which they issued notices under SARFAESI Act 2002' How are provisions of SARFAESI Act help full for reduction of NPA's ? In your opinion what more can be done to reduce NPA load in Indian Public Sector Banks ?

Answer : 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 if 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.

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

From above, it is very clear that SARFAECI Act 2002 proved a great help to public sector banks in reducing their NPA's. The provisions of this Act are being continuously used by banks for overcoming the problem of NPA's.

Beside this SARFAECI Act, following measures may also be used to reduce NPA's :

1. **Preventive Measures** :

- **Credit assessment and risk management mechanism** : The lasting solution to the problem of NPA's is scientifically done credit assessment of borrower and follow risk management mechanism.
- **Organizational restructuring** : to have adequate machinery to constantly follow up the borrower and change in the attitude for taking up legal recourse for recovery.
- **Check/Vigil on border line cases** : so that these cases could not turn out to be NPA's.

2. **Curative Measures**

- **Powers of Debt Recovery Tribunals** : Need to be enhanced so that they become more effective in recovery matters.

- **Lok Adalats** : The institution of lok adalats can also help the banks in reducing their NPA's. In case of smaller loan cases, this institution has proved very useful.
- **Asset Reconstruction Companies** : can also take of bad loans and help banks in reducing and recycling of funds blocks in NPA'S.
- **Re-structuring of debt** : can also be resorted by banks when borrowers could not repay loan due to factors beyond their control. In such cases, reconstruction or rephrasing of loan can be done by banks.

Question 5 Highlight some customer relationship management initiative being pursued by Indian banks. Explain in brief few innovating product portfolios of banks towards higher customer orientation and responsiveness.

Answer : 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 meeting 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 started keeping their Manages 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

Customers	Employees	Bank
They feel empowered and have greater access to products & services. Offer of products and services can be timed with customers requirements e.g. edu. Loan with up to date information of customers, personalized services can be arranged.	Have more time to serve customers and are empowered with information to deliver high quality of products & services to meet customers expectation.	Optimum use of resources with greater loyalty and customer satisfaction. Bank can retain existing customers and can attract new customers due to better CRM. Bank executives can better utilize opportunities to increase business of bank and increase the overall profitability.

Some innovative products & portfolios of banks towards CRM :

Following key steps have been initiated by some banks :

- **Appointment of Customer Relations Managers/Executives** : in banks who are working with “help desks” of bank and helping the customers in account opening and getting various facilities from banks.
- **Distribution of Insurance Products to Customers** and linking of deposits with insurance cover benefit to existing depositors of saving account.
- **Creating healthy environment for customers** : by creating proper sitting space with air cool facilities, arrangement of water coolers in summer. To attract new customers, some banks has also provided tea/coffee machines inside bank premises.
- **Concessional rate of services to existing customers** for example collection and payment of utility bills at very nominal rate, lower charges for RTGS and other modes of fund transfer for existing customers through their saving & current account.
- **Displaying charges of various services in customers** lobby including new scheme of deposits etc.

- Question 6** Write short notes on
- (i) **Bank assurance**
 - (ii) **e-banking**

Answer : (i) **Bank assurance**

Bank 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 'bancassurance'

For a Bank are :

- product diversification
- generating additional income

For a 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

- i. The Rules of IRDA requires a mandatory 4 weeks training for selling insurance products which a bank employee find it difficult to undergo.
- ii. Most of the bank branches particularly in rural areas are not fully computerized and there are problems when work of insurance is handled manually.
- iii. 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.

- iv. 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 bank for selling their products through banks and generating additional income.

(ii) **E-Banking**

Also known as internet banking, e-banking means any user with a personal computer (PC) can get connected to his banks website to perform any of banking functions. In it, a bank has centralized data base which is web enabled. All the services that the bank has permitted on internet are displayed on menu and customer can avail these services through his P.C.

Objects of e-banking

- To provide services in customers own environment and convenience and accessibility
- To reduce risk of cash handling
- To provide services at very low cost
- To provide system that delivers efficient payment linked to a bank account.

E-banking has following dimensions

- Customer to bank e-banking
- Bank to bank e-banking
- Electronic central banking
- Internet procurement

Following services can be availed through e-banking

- Bill payment services
- Fund transfer
- Railway passes online
- Investing through internet
- Re-charging prepaid phones
- Shopping and purchase of rail & air tickets

Question 7 With relatively strong markets since 2003 despite global recession, private banks forging ahead, and the Indian Reserve Bank maintaining its Prudent Stance on macroeconomic management, India has a reputation for robust financial institutions.

These are star turns, however, in a financial system that elsewhere remains socket firmly in the government's grip in India. A substained program of liberal reforms could release as much as 48 billion of capital a year for investment. Coupled with broader reforms that promote job creation, financial sector liberalization could raise real GDP growth to 9.4% just shy of the government's 10% target, and well above the 7% levels seen in recent years. This would increase household incomes 30% above current projections by 2014, lifting millions move out of poverty.

To realize gains on this scale, though the government must surrender control of the Financial System. That would allow banks to draw in more savings, allocate them to more productive investments and do both jobs more productive investments and do both jobs more efficiently. A raft of regulations governing banks, financial intermediaries, and bond markets now serve to channel most saving directly to the government or its priority investments. These rules are partly motivated by admirable welfare aims such as maintaining rural incomes. But they leave the most productive areas of India's economy short of capital, holding back growth on which all incomes ultimately depend.

- (a) Explain the role of financial intermediaries in growing economies.
- (b) Do you agree that liberalized banking norms can boost Indian GDP to double digit growth ? How ? What can be the possible shortcomings of such a policy ?

Answer

- (a) Financial intermediaries play a crucial role in growing economies through their role of collecting savings from those having surplus money and making this money available to those who need it for production of goods and services. They ultimately provide money to all key sectors of economy on which growth and development of economy depends. These key sectors are agriculture, industry, infrastructure and service sector. Financial intermediaries deploy

the savings so collected to these core sectors of economy leading to their growth and development.

These financial intermediaries can be classified as :

- I **Banking and non banking inter mediaries** : Banking inter mediaries include commercial and cooperative banks
Non banking financial inter mediaries include LIC, GIC, NBFC's etc.
LIC is the highest investment banker which deploys its funds for various developmental activities.
 - II **Money market and capital market inter mediaries**
Money market intermediaries consists of RBI, Commercial banks, Cooperative bank, P.O. saving banks etc.
Capital market intermediaries include development banks, Insurance companies, UTI , NBFC's etc.
All the above intermediaries help in providing financial resources to all core sectors of economy and thus help in growth of the economy.
- (a) Liberalized banking norms for making loans and advances for individuals, firms, corporate would certainly help in increasing the production of goods and services in the country resulting to increase in GDP rate to double digit. With all around increase in production, GDP is going to rise.

However, there is a great risk of inflation due to this liberalized banking norms. Our country is facing the same problem of high inflation rate. This inflation rate went up to 21% in May 2010 and caused a great cause of worry for both the govt. as well as RBI.

To curb this inflation, RBI as central bank of the country has revised its two key rates i.e. repo rate and reverse repo rate 10 times since March 2010. These rates were 5% and 3.5% respectively in March 2010 which have gone up to 7.5% and 6.5% respectively in June 2011. RBI increase these rates to make bank loans more costly so that getting loans from banks may become more costly which would directly control money supply in market and thus help in controlling inflation.

Hence it would be better to avoid liberalized norms on lending by banks.

