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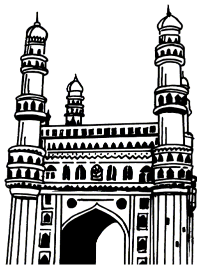

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UNIT I

INTRODUCTION TO BANKING:

Evolution of Commercial Banking in India, Definition of Banker, Customer, Functions of Reserve Bank and Commercial Bank. Emerging role of bankers and Role of Banks in Economic development, Reforms in banking sector, Global financial crisis & Indian banking sector.

1.1 Introduction to Banking

Q1. Define the term Bank. Discuss the various definitions of Bank.

Ans :

Meaning

The word 'Bank' has been derived from the Latin word 'bancus' or 'banque'. The meaning of it in English is a bench. The early bankers transacted their business at benches in a market place. According to some authorities, the word bank was originally derived from German word bank. It means a joint stock fund. This word later on was called as 'banco' in Italy when a great part of Italy was ruled by the Germans.

A bank is a financial institution which deals with deposits and advances and other related services. It receives money from those who want to save in the form of deposits and it lends money to those who need it. A bank is a financial institution and a financial intermediary that accepts deposits and channels those deposits into lending activities, either directly by loaning or indirectly through capital markets. A bank is the connection between customers that have capital deficits and customers with capital surpluses.

Definitions

i) **According to F.E. Perry :** "The bank is an establishment which deals in money, receiving it on deposit from customers, hounouring customer's drawings against such deposits on demand, collecting cheques for customers and lending or investing surplus deposits until they are required for repayment."

ii) **According to Walter Leaf :** "A banker is an institution or individual who is always ready to receive money on deposits to be returned against the cheques of their depositors."

iii) **According to Dr. Herbert L. Hart :** "A banker is one who in the ordinary course of his business, honours cheques drawn upon him by persons from and for whom he receives money on current accounts."

iv) **According to The Indian Banking Companies Act, 1949 :** "Banking means the acceptance for the purpose of lending or investment, of deposits of money from the public repayable on demand or otherwise, and withdrawal by cheque, draft, order or otherwise".

1.1.1 Evolution of Commercial Banking in India

Q2. Explain the Evolution of Commercial Banking in India.

Ans :

Modern banking as evolved in England was introduced by the British during their rule in India. Naturally, today's Indian banking is similar to British banking. However, it does not mean that banking was unknown to India. The essence of banking is lending for Evolution of Banking productive purposes. In fact, India was a major partner in international trading and was a big producer of steel, cloth, spices and luxurious articles. There are references to rate of interest, security of the loans in the Manusmrity. Kautilya in the 'Artha Shastra' mentions regulation of interest rates, deposits and even discounting of bills. They were called 'Hundies'. The big merchants, traders and moneylenders called 'Sresthis' or "Nagarseths" occupied important positions in the Mughal and Maratha courts. They had efficient courier system, extensive branches all over India and they gave loans to the kings also.

However, modern banking with its double-entry accounting system and insistence on deposit mobilization was introduced by the British. As the British rule extended all over the country, the stages in evolution in Banking in India. Modern banking also spread driving out the indigenous banking.

Stages in the Evolution of Banking in India :

Some important stages in the evolution of modern banking in India are as follows :

1. **Agency Houses :** When the English traders came to India, they had problem of raising working capital due to the language barrier. Therefore, they established Agency Houses which combined trading with banking. One agency house established the first bank in India called the Bank of Hindustan in 1770. Later on, many banks were established. But they disappeared as fast as they were born. Anybody could then start a bank. The field was free for all.

2. **Presidency Banks :** The East India Co., the ruler of India, took initiative in establishing Presidency Banks by contributing 20% of their share capital to meet its own demand for funds. Accordingly, Bank of Bengal, Bank of Bombay and Bank of Madras were established in 1806, 1840 and 1943 respectively.

3. **Joint Stock Banks :** In 1884, banks were allowed to be established on the principle of limited liability. In due course, this encouraged establishment of banks. By the turn of the century, many banks with the initiative of Indians were established. Punjab National Bank, Allahabad Bank, Bank of Baroda are some of the banks then established. Many foreigners also came in the field of Indian banking.

4. **Imperial Bank of India :** To meet the competition of foreign banks, the three Presidency Banks were amalgamated and a powerful Imperial Bank of India was established in 1921 with its network of branches all over the country. This bank was later nationalised in 1955 and it is today's State Bank of India. This is a prestigious bank as the Government is its customer.

5. **Establishment of the Reserve Bank of India :** Though there was boom in banking, due to absence of any regulation and facility of timely assistance there were recurrent bank failures. This resulted in suspicion about banks in the minds of the people. They stayed away from banks. The need for a separate Central Bank was emphasised by the HiltonYoung Commission. Accordingly, the RBI was established in 1935 to perform all the functions of a Central Bank. It was modeled on the pattern of the Bank of England. But it did not have much power of regulation. The period was also critical one due to the great depression and the subsequent Second World War. The RBI could not do much about banking.

6. **Nationalisation of the RBI and the Banking Regulation Act :** These two important steps were taken in 1949. Immediately after independence wide powers of regulation and control were given to the RBI and by making use of those powers the RBI was successful in making Indian banking trustworthy. Soon, bank failures became a thing of the past and India's banks progressed under the guidance of the RBI. Many malpractices, deficiencies and drawbacks were sought to be removed by the RBI.

7. **Nationalisation of Banks in 1969 and 1980 :** Another significant step was taken in 1969 by nationalising 14 big Indian banks. Then six more banks were nationalised in 1980. The nationalisation of banks brought about a sea-change in the policies, attitudes, procedures, functions and coverage of banks. Indian banks are now being prepared to become international players. These are the stages through which Indian banking developed.

Q3. Discuss the features of a commercial bank.

Ans :

Characteristics of a bank can be given as follows :

1. **Dealing in Money :** Bank is a financial institution which deals with other people's money i.e. money given by depositors.
2. **Individual / Firm / Company :** A bank may be a person, firm or a company. A banking company means a company which is in the business of banking.
3. **Acceptance of Deposit :** A bank accepts money from the people in the form of deposits which are usually repayable on demand or after the expiry of a fixed period. It gives safety to the deposits of its customers. It also acts as a custodian of funds of its customers.
4. **Giving Advances :** A bank lends out money in the form of loans to those who require it for different purposes.
5. **Payment and Withdrawal :** A bank provides easy payment and withdrawal facility to its customers in the form of cheques and drafts. It also brings bank money in circulation. This money is in the form of cheques, drafts, etc.
6. **Agency and Utility Services :** A bank provides various banking facilities to its customers. They include general utility services and agency services.
7. **Profit and Service Orientation :** A bank is a profit seeking institution having service oriented approach.
8. **Ever increasing Functions :** Banking is an evolutionary concept. There is continuous expansion and diversification as regards the functions, services and activities of a bank.
9. **Connecting Link :** A bank acts as a connecting link between borrowers and lenders of money. Banks collect money from those who have surplus money and give the same to those who are in need of money.
10. **Banking Business :** A bank's main activity should be to do business of banking which should not be subsidiary to any other business.
11. **Name Identity :** A bank should always add the word "bank" to its name to enable people to know that it is a bank and that it is dealing in money.

1.1.2 Definition of Banker, Customer

Q4. Define the term banker.

Ans : **(Oct.-20, Imp.)**

Definition

i) **According to Banking Regulations Act, 1949, Section 5(b):** Banking is defined as "accepting for the purpose of lending or investments of deposits of money received from the public and repayable on demand and withdrawable by cheque, draft, order or otherwise". Thus, the term banker is not defined by B R Act but it defines the term "Banking". This definition highlights two points:

   1. The primary function of a banker is accepting of deposits for the purpose of lending or investing the same;
   2. The amount deposited is repayable to the depositor on demand or according to the agreement. The demand for repayment can be made through a cheque, draft or otherwise, and not merely by verbal order. Let us see some definitions of Banker.

ii) **According to Dr. Herbert L. Heart,** "A Banker is one who in the ordinary course of business honours cheques drawn upon him by any persons from and for whom he receives money on current accounts".

iii) **According to Sec. 3 of the Indian Negotiable Instruments Act 1881,** the word "banker includes any person acting as banker and any post office savings bank".

iv) **According to Sec. 2 of the Bill of Exchange Act, 1882,** 'banker includes a body of persons, whether incorporated or not who carry on the business of banking.'

From the above definitions, we can derive the meaning of banker as one who

- Accepts deposits from public
- Grants loans and advances
- Issue and pay cheques
- Collect cheques for his customers

The word 'public' implies that the banker accepts deposits from anyone who offers money for deposit purpose. For the purpose of receiving deposit, the customer has to open an account with the bank. For both depositing and borrowing funds, customer has to have an account relationship with the bank. The RBI has stipulated "Know Your Customer (KYC) Norms" for opening bank account and the bankers are strictly following the same. Hence, if a customer is not transparent, the banker has the right to rejects his/her application.

Q5. Define the term 'Customer'.

Ans :

Meaning

The term 'Customer' is not defined by any act either in India or in English Statutes. The word 'customer' has its origin from the word 'custom', which means a 'habit or tendency' to-do certain things in a regular or a particular manner. Generally speaking, a customer is one who has an account with the bank or who utilizes the services of the bank.

Account relationship is a contractual relationship. It is generally believed that any individual or an organization, which conducts banking transactions with a bank, is the customer of bank. However, there are many persons who do utilize services of banks, but do not maintain any account with the bank. Therefore, bank customers can be conveniently classified into four types. They are :

(a) Existing customers

(b) Former customers

(c) Customers for services like Demand Draft purchase, cheque encasement, etc.

(d) Potential customers

Definition

According to Pirvu, "Customers are bank depositors, who entrust their money, banking facilities, for storage and fruiting, for which they receive interest and applicants or those who need temporary, some additional money for paying interest or commission".

1.1.3 Functions of Commercial Bank

Q6. What are the functions of Commercial Banks?

(OR)

Explain the functions of Commercial Banks?.

(OR)

Explain in detail primary functions of Commercial Banks.

(OR)

Explain the secondary functions of Commercial Banks?

Ans : **(Imp.)**

Functions of commercial banks are divided in the following main categories:

1. Primary Functions

i. Accepting deposits

(a) Saving Deposits

(b) Current Deposits

(c) Fixed Deposits

(d) Other Deposits

ii. Advancing loans

(a) Cash credit

(b) Overdraft

(c) Loans

(d) Discounting bill of Exchange.

iii. Investments of funds

iv. Credit creation

2. Secondary Functions

i. Agency functions

ii. General utility functions

1. Primary Functions

i) Accepting Deposits

The most important function of commercial banks is to accept deposits from public. This is the primary functions of a commercial bank. Banks receives the idle savings of people in the form of deposits and finances the temporary needs of commercial and industrial firms.

A commercial bank accept deposit from public on various account, important deposit account generally kept by bank are:

a) **Saving Deposits:** This type of deposits suit to those who just want to keep their small savings in a bank and might need to withdraw them occasionally. One or two withdrawals upto a certain limit of total deposits are allowed in a week. The rate of interest allowed on saving bank deposits is less than that on fixed deposits. Depositor is given a pass book and a cheque book. Withdrawals are allowed by cheques and withdrawal form.

b) **Current Deposits:** This type of account are generally kept by businessmen and industrialists and those people who meet a large number of monetary transactions in their routine. These deposits are known as short term deposits or demand deposits. They are payable demand without notice. Usually no interest is paid on these deposits because the bank cannot utilize these deposits and keep almost cent per cent reserve against them. Overdraft facilities are also available on current account.

c) **Fixed Deposits:** These are also known as time deposits. In this account a fixed amount is deposited for a fixed period of time. Deposits are payable after the expiry of the stipulated period. Customers keep their money in fixed deposits with the bank in order of earn interest. The banks pay higher interest on fixed deposits. The rates depend upon the length of the period and state of money market. Normally the withdrawals are not allowed from fixed deposits before the stipulated date. If it happens, the depositor entails an interest penalty.

d) **Other Deposits:** Banks also provide deposit facilities to different type of customers by opening different account. They also open. 'Home Safe Account' for housewife or very small savers. The other accounts are : 'Indefinite Period Deposit a/c'; 'Recurring Deposit' a/c; 'Retirement Scheme' etc.

ii) Advancing Loans

The second main function of the commercial bank is to advance loans. Money is lent to businessmen and trade for short period only. These banks cannot lend money for long period because they must keep themselves ready to meet the short term deposits. The bank advances money in any one of the following forms :

a) **Cash Credit :** Cash Credit is a type of advance wherein a banker permits his customer to borrow money upto a particular limit by a bond of credit with one or more securities. The advantage associated with this system is that a customer can withdrawn money as and when required. The bank will charge interest only on the actual amount withdrawn by the customer. Many industrial concerns and business houses borrow money in this form.

b) **Overdraft :** An overdraft is an arrangement by which the customer is allowed to overdraw his account. It is granted against some collateral securities. The facility to overdraw is allowed through current account only. Interest is charged on the exact amount of overdrawn subject to the payment of minimum amount by way of interest.

c) **Loan :** Loan is an advance in lump sum amount the whole of which is withdrawn and is supported to be rapid generally wholly at one time. It is made with or without security. It is given for a fixed period at in agreed rate of interest. Repayments may be made in installments or at the expiry of a certain period.

d) **Discounting Bill of Exchange:** The bank also gives advances to their customers by discounting their bills. The net amount after deducting the amount of discount is credited to the account of customer. The bank may discount the bills with or without any security from the debtor in addition to the personal security of one or more person already liable on the bill.

iii) Investment of Funds

Besides loan and advances, banks also invest a part of its funds in govt. and industrial securities. Banks purchases both govt. and industrial securities like govt. bills, share, debentures, etc from their market.

iv) Credit Creations

The banks create credit. When a bank advances a loan, it does not give cash to the borrower. It opens an account in the name of the borrower. The borrower is allowed to withdraw money by cheque whenever he needs. This is known as Credit Creation.

2. Secondary Functions

It is divided into two parts :

i) Agency Services

Modern Banks render service to the individual or to the business institutions as an agent. Banks usually charge little commission for doing these services. These services are as follows:

a) **Remittance of Funds:** Banks help their customers in transferring funds from one place to another through cheques, drafts etc.

b) **Collection and Payment of Credit Instruments:** Banks collects and pays various credit instruments like cheques, bill of exchange, promissory notes etc.

c) **Purchasing and Sale of Securities:** Banks undertake purchase and sale of various securities like shares, stocks, bonds, debentures etc. on behalf of their customers. Banks neither give any advice to their customers, regarding this investment, nor levy any charge of them for their services, but simply perform the function of a broker.

d) **Income Tax Consultancy:** Sometimes bankers also employ income tax experts not only to prepare income tax returns for their customer but to help them to get refund of income tax in appropriate cases.

e) **Acting as Trustee and Executor :** Banks preserve the wills of their customers and execute them after their death.

f) **Acting as Representatives and Correspondent :** Sometimes the banks act as representatives and correspondents of their customers. They get passports, travelers tickets secure passages for their customers and receive letters on their behalf.

ii) General Utility Services

A modern bank now a days serves its customers in many other ways:

a) **Locker Facility:** Banks provides locker facility to their customers. The customers can keep their valuables and important documents in these lockers for safe custody.

b) **Traveler's Cheques:** Bank issue travelers cheques to help their customers to travel without the fear of theft or loss of money.

c) **Gift Cheque :** Some banks issue cheques of various denominators to be used on auspicious occasions. These are known as "gift cheques" as they are gifted to others.

d) **Letter of Credit :** Letter of credit are issued by the banks to their customers certifying their credit worthiness. Letter of credit are very useful in foreign trade.

e) **Foreign Exchange Business:** Banks also deal in the business of foreign currencies. Again, they may finance foreign trade by discounting foreign bills of exchange.

f) **Collection of Statistics:** Banks collects statistics giving important information relating to industry, trade and commerce, money and banking. They also publish journals and bulletins containing research articles on economic and financial matters.

1.2 Reserve Bank of India

Q7. Write about Reserve Bank of India.

Ans :

Meaning

The Reserve Bank of India (RBI) is the apex financial institution of the country's financial system. It is entrusted with the task of control, supervision, promotion, development and planning.

The Reserve Bank of India influences the management of commercial banks through its various policies, directions and regulations. Its role in bank management is quite unique. It performs the four basic functions such as planning, organizing, directing and controlling in laying a strong foundation for the functioning of commercial banks.

The Reserve Bank of India is India's central bank. It came into existence on 1st April 1935 under the Reserve Bank of India Act, 1934.

History

In 1921, the Imperial Bank of India was established to perform as central bank of India by the British Government. But unfortunately Imperial Bank failed to show its performance up to the mark and didn't achieve any success as the Central Bank. Then the Government asked the Hilton Young Commission in 1925 to view on this subject.

The commission submitted their reports saying that one single organization can't be able to act as two separate agencies (both credit and currency control). So, it's required to set up a brand new central bank. In 1st April 1935, Reserve Bank of India was set up. In January, 1949, RBI was nationalized.

Q8. What are the objectives of RBI ?

Ans :

Objectives of RBI

Prior to the establishment of the Reserve Bank, the Indian financial system was totally inadequate on account of the inherent weakness of the dual control of currency by the Central Government and of credit by the Imperial Bank of India.

The Preamble to the Reserve Bank of India Act, 1934 spells out the objectives of the Reserve Bank as: "to regulate the issue of Bank notes and the keeping of reserves with a view to securing monetary stability in India and generally to operate the currency and credit system of the country to its advantage."

The important objectives are:

1. **To act as Monetary Authority**

   Formulates implements and monitors the monetary policy to maintain price stability and ensuring adequate flow of credit to productive sectors.

2. **To Regulate and supervise the financial system of the country**

   It prescribes broad parameters of banking operations within which the country's banking and financial system functions. It helps to maintain public confidence in the system, protect depositors' interest and provide cost-effective banking services to the public.

3. **To Manage the Exchange Control**

   Manages the Foreign Exchange Management Act, 1999 to facilitate external trade and payment and promote orderly development and maintenance of foreign exchange market in India.

4. To Issue Currency

Issues and exchanges or destroys currency and coins not fit for circulation to give the public adequate quantity of supplies of currency notes and coins and in good quality.

5. To Undertake Developmental Role

RBI performs a wide range of promotional functions to support national objectives.

6. To undertake related Functions by acting as

- Banker to the Government: performs merchant banking function for the central and the state governments; also acts as their banker.
- Banker to banks: maintains banking accounts of all scheduled banks.
- Owner and operator of the depository (SGL-Subsidiary General Ledger account) and exchange (NDS)

Negotiated Dealing System is an electronic platform for facilitating dealing in Government Securities and Money Market Instruments that will facilitate electronic submission of bids/application for government bonds.

To sum up the objectives include:

1. To manage the monetary and credit system of the country.
2. To stabilizes internal and external value of rupee.
3. For balanced and systematic development of banking in the country.
4. For the development of organized money market in the country.
5. For facilitating proper arrangement of agriculture finance and be in successful for maintaining financial stability and credit in agricultural sector.
6. For proper arrangement of industrial finance.
7. For proper management of public debts.
8. To establish monetary relations with other countries of the world and international financial institutions.
9. For centralization of cash reserves of commercial banks.
10. To maintain balance between the demand and supply of currency.
11. To regulate the financial policy and develop banking facilities throughout the country.
12. To remain free from political influence while making financial decisions

To assist the planned process of development of the Indian economy. Besides the traditional central banking functions, with the launching of the five-year plans in the country, the Reserve Bank of India has been moving ahead in performing a host of developmental and promotional functions, which are normally beyond the purview of a traditional Central Bank.

Q9. What are the functions of RBI ?

(OR)

Discuss the main functions of RBI.

(OR)

Write about the functions of reserve bank.

(OR)

Describe the functions of reserve bank of India (RBI).

Ans : **(Aug.-21, Oct.-20)**

The Reserve Bank of India Act, 1934, confers upon it the powers to act as note-issuing authority, banker's bank to the Government. As the Central Bank of the country, the Reserve Bank of India performs both the Traditional Functions of a central bank and a variety of developmental and promotional functions.

Functions of RBI

1. Monetary Functions

a) Bank of Note Issue
b) Currency Chest
c) Banker to Government
d) Bankers Bank
e) Lender of the Last Resort
f) Banker, Agent & Adviser to the Government
g) Custodian of the Cash Reserves of Commercial Banks
h) Custodian of Foreign Balances of the Country
i) Controller of Credit

2. Non-Monetary Functions

a) Supervisory Functions

b) Promotional Functions

1. Monetary Functions

a) Bank of Note Issue

The currency of our country consists of one-rupee notes and coins (including subsidiary coins) issued by the government of India and bank note issued by RBI. As required by Section 38 of RBI Act, government puts into circulation one rupee coins & notes through RBI only. RBI has the sole right to issue bank notes in India. The notes issued by RBI and the one-rupee notes & coins issued by the government are unlimited legal tender. RBI also bears the responsibility of exchanging notes & coins into those of other denominations as required by the public.

The assets of the Issue Department against which bank notes are issued consist of the following:

- Gold Coins & Bullion
- Foreign Securities
- Rupee Coins
- Government of India Rupee Securities
- The bill of exchange and promissory notes payable in India, which are eligible for purchase by the Bank.

b) Currency Chest

RBI has made adequate administrative arrangements for undertaking the function of distribution of currency notes & coins. The Issue department has opened its offices in 10 leading cities for this purpose. More ever, currency chest have been maintained all over the country to facilitate the expansion and contraction of currency in the country.

c) Banker to Government

RBI to the central & state Government. According to section 20 of RBI Act, 1934 it is obligatory for the RBI to transact government business including the management of the public debt of the union. Section 21 requires the Central Government to entrust RBI all its money, remittance, exchange and banking transactions in India and, in particular, deposits free of interest all it cash balances with RBI.

In terms of section 21-A, RBI performs similar function on behalf of the State Government. RBI has entered into agreements with the Central and State Government for carrying of these functions.

For conducting ordinary banking business of the Central Government, RBI is not entitled to any remunerations it holds cash balances of the Government of the Government free of interest. For the management of public debt, RBI is entitled to charge a commission. RBI is also required to maintain currency chests of its Issue Department at places prescribed by the Government and to maintain sufficient notes & coins therein.

d) Bankers Bank

RBI is the banker to the banks – Commercial, Co-operative & Regional Rural Banks (RRBs). This relationship is established once the name of a bank is included in the second schedule to the RBI Act, 1934. Such banks are called scheduled banks. The category of scheduled banks includes.

i) Commercial Banks – Indian and foreign

ii) Regional Rural Banks &

iii) State Co-operative Banks

A **'Schedule Bank'** means a bank included in the second schedule to the RBI Act, 1934. The Reserve Bank is empowered to include in the second schedule the name of a bank, which carries on the business of banking in India and which satisfies the following conditions laid down in section 42(6):

i) It must have a paid-up capital and reserve of an aggregate value of not less than Rs.5 lakhs;

ii) It must satisfy RBI that its affairs are not being conducted in a manner determined to the interest of its depositors, and

iii) It must be;

- A state co-operative bank or
- A company as defined in the companies act, 1956, or

iv) An institution notified by the central government in the behalf, or

v) A corporation or a company incorporated by or under any law in force in any place outside India.

e) Lender of the Last Resort

As the banker to the banks, RBI acts as the lender of the last report and grants accommodation to the scheduled banks in the following forms;

i) Rediscounting or purchase of eligible bills, Section 17(2) & (3)

ii) Loans and advances against certain securities, Section 17(4)

iii) Rediscounting of Bills. Section 17(2) lays down that the following categories of bill are eligible for rediscounting with the Reserve Bank.

- Commercial Bills
- Bill of Financing Agricultural Operations.
- Bill of financing cottage and small-scale industries.
- Bill of holding or trading in Government Securities.
- A foreign bill

iv) Loans and Advances: Section 17(4) enables RBI to grant loans, & advances to the scheduled banks, repayable on demand or on the expiry of fixed periods not exceeding 90 days against the security of the following :

- Stock, funds and securities (other than immovable property) in which a trustee is authorized to invest trust money
- Gold or silver or documents of title to the same
- Such bills of exchange and promissory notes as are eligible for purchase or re-discount by RBI (state above) or those guaranteed by the state governments as the repayment of the principal and interest.
- Promissory notes of any scheduled bank or state co-operative Bank support by documents of title to goods.

f) Banker, Agent and Adviser to the Government

Central banks everywhere perform the functions of banker, agent and adviser to the Government. As banker to the Government, the central bank of the country keeps the banking accounts of the Government-both of the Centre & of the States-performs the same functions as a commercial bank ordinarily does for its customers.

As a banker and agent to the Government, the central bank makes and receives payments on behalf of Government. It helps the Government with short-term loans and advances (known as ways and means advances) to tide over temporary difficulties and also floats public loans for the Government. It also manages the public debt (i.e., floats, services & redeems Government loans). It advises the Government on monetary and economic matters

g) Custodian of the Cash Reserves of Commercial Banks

All commercial banks kept part of their cash balances as deposit with the central banks of the country, either because of convention or because of legal compulsion. They regularly draw currency from the central bank during the busy season and pay in surplus currency during slack season. Part of these balances are meant for clearing purposes. That is all commercial banks keep deposit accounts with central bank, payment by one hank to mother will be simple book entry adjustment in the books of the central bank. The deposit balances with central bank are considered as cash reserves for general purposes.

h) Custodian of Foreign Balances of the Country

Under the gold standard, countries maintained gold as reserve against the issue of currency. But after World War 1, the central banks in most countries have maintained both gold as well as foreign currencies as reserves against note issue and also to meet any adverse balance of payments with any other country. It is the responsibility of the central bank of the country to maintain the rate of exchange fixed by the Government and manage exchange control and other restrictions imposed by the state.

i) Controller of Credit

Probably the most important of all the functions performed by a central bank is that of controlling the credit operations of commercial banks. In modern times bank credit his become the most important source of money in the country, relegating coins and currency noted to a minor position for commercial banks to expand credit and thus intensify inflationary pressure or contract credit & thus contribute to a deflationary situation. It is, thus, of great importance that there should he some authority which will control the credit creation by commercial banks. As controller of credit the central bank attempts to influence and control the volume of bank credit & also to stabilize business conditions in the country

2. Non-Monetary Functions

a) Supervisory Functions

In addition to its traditional central banking functions, RBI has certain non-monetary functions of the nature of supervision of banks and promotion of sound banking in India. The RBI Act, 1934, and the Banking Regulation Act, 1949, have given RBI wide powers of supervision and control over commercial and co-operative banks relating to licensing and establishment, branch expansion, liquidity of their assets, management and methods of working, amalgamation, re-construction and liquidation. RBI is authorised to carry out periodical inspections of the banks and a call for returns and necessary information from them. The nationalization of 14 major Indian scheduled banks in July 1969 has imposed new responsibilities on RBI for redirecting the growth of banking and credit policies towards more rapid development of the economy and realization of certain desired social objectives. The supervisory functions of RBI have helped a great deal in improving the standard banking in India to develop on sound lines and to improve the methods of their operation.

b) Promotional Functions

With economic growth assuming a new urgency since Independence, the range of RBI's function has steadily widened. The Bank now performs a variety of developmental & promotional functions. Which at one time were regarded as outside the normal scope of central banking. RBI was asked to promote banking habit, extend banking facilities to rural and semi-urban areas, & establish & promote new specialized agencies.

Accordingly, RBI has helped in the setting up of IFCI and SFCs; it set up the Deposit Insurance Corporation in 1962, the Unit Trust of India in 1964, the industrial Development Bank of India also in 1964, the Agricultural Re-finance Corporation of India in 1963, the Industrial Re-constructions Corporation of India in 1972 & NABARD in 1982. These institutions were set up directly or indirectly by RBI to promote savings habit and to mobilize savings, to provide industrial finance as well as agriculture finance.

1.3 Emerging Role of Bankers

Q10. Explain the concept of Emerging Role of Bankers.

(OR)

What are the emerging role of bankers?

(OR)

Discuss the emerging role of banker.

Ans : **(Dec.-21, May-19, Imp.)**

The following are the emerging trends in commercial banking which highlights the role of bankers in India,

1. **E-Banking**

   E-Banking is also known as online banking and internet banking. In simple words, e-banking refers to the performance of any or all banking transactions using the internet as a safe and secure platform for completing the banking transaction.

2. **Mobile Banking**

   Mobile banking refers to the process of carrying out any banking transaction through internet with help of mobile phone. The increasing use of mobile phones has led to the introduction of mobile banking. The developed countries provide the mobile banking services for payment of small value transactions at low cost. The mobile banking consists of two types of models, (a) The bank led model (b) The telecom led model. In India the bank-led model is used. The countries which don't have a wide spread banking network may use the telecomled model.

3. **Core Banking**

   Core banking is a banking service provided by a group of networked bank branches where customers may access their bank agent and perform basic transactions from any of the member branch offices. Core banking solution is defined as the set of powerful software components or integration of core banking components that are developed and tailored to satisfy the requirements of the individual businesses in order to face the challengers in the banking sector. The modules of core banking solution include saving bank account, current account, fixed deposits, cash credit, etc., and in addition include ATM and internet banking. While replacing the traditional solutions with core banking solution, banks should follow a holistic approach to minimize and effectively manage the risks associated with it.

4. **Bank Assurance**

   The distribution channels set-up by banks for the purpose of selling insurance products is known as Bancassurance. It is derived from the French term 'bancassurance' which was first introduced in 1980. Earlier French banks sold more insurance policies. However, the selling of insurance policies by banks became a common practice in most of the European countries and the United States. This practice was adopted even by most of the Asian Banks. The increased population in India and a wide network of banks with low insurance penetration forced the Indian banks to enter into the insurance business.

5. **Banking Ombudsman**

   Banking Ombudsman scheme has been formulated by Reserve Bank of India for providing service to the Bank clients. Bank Ombudsman resolves the problems relating to Banking service and other matters as specified under the scheme. Banking Ombudsman came into force from Jan-1-2006. The members of Banking Ombudsman are elected by RBI. The NRI's can even file the complaints if they are facing deficiency in the services provided to them by the Banks. Numerous complaints have been settled by Banking Ombudsman.

1.4 Role of Banks in Economic Development

Q11. Explain the Role of Banks in Economic Development.

Ans : **(Dec.-21, Aug.-21, May-19, Imp.)**

Banks play a very useful and crucial role in the economic life of every nation. They have control over a large part of the supply of money in circulation, and they can influence the nature and character of production in any country. In order to study the economic significance of banks, we have to review the general and important functions of banks.

1. Removing the deficiency of capital formation

In any economy, economic development is not possible unless there is an adequate degree of capital accumulation (or) formation. Deficiency of capital formation is the result of low saving made by the community. The serious capital deficiency in developing economies is reflected in small amount of capital equipment per worker and the limited knowledge, training and scientific advance. At this juncture, banks play a useful role. Banks stimulate saving and investment to remove this deficiency. A sound banking system mobilizes small savings of the community and makes them available for investment in productive enterprises. The important implications of this activity include Banks mobilise deposits by offering attractive rates of interest and thus convert savings into active capital. Otherwise that amount would have remained idle.

Banks distribute these savings through loans among productive enterprises which are helpful in nation building.

It facilitates the optimum utilization of the financial resources of the community.

2. Provision of finance and credit

Banks are very important sources of finance and credit for industry and trade. It is observed that credit is the lubricant of all commerce and trade. Hence, banks become nerve centers of all trade activities and therefore commerce and trade could function in the presence of sound banking system.

The banks cover foreign trade transactions also. Big banks also undertake foreign exchange business. They help in concluding deferred payments, arrangements between the domestic industrial undertakings and foreign firms to enable the former import machinery and other essential equipment.

3. Extension of the size of the market

Commercial bankers help commerce and industry in yet another way. With the sound banking system, it is possible for commerce and industry for extending their field of operation. Commercial banks act as an intermediary between buyers and the sellers. Goods are supplied on bank guarantees, making it viable for industry and commerce to cultivate and locate markets for their products. The risks are undertaken by the bank. When the risks have been set free by the banks, the industry can look forward to derive economies of the large size of the market.

4. Act as an engine of balanced regional development

Commercial banks help in proper allocation of funds among different regions of the economy. The banks operate primarily for profits. When the banks lend their funds for more productive uses, their profits will be maximized. Introduction of branch banking makes it possible to choose between different regions. A region with growth potential attracts more bank funds. But in recent years, the approach of banks towards regional growth has been undergoing a change. Banks help create infrastructure essential for economic development. Thus banks are engines of balanced regional development in the country.

5. Financing agriculture and allied activities

The commercial bank helps the farmers in extending credit for agricultural development. Farmers require credit for various purposes like making their produce, for the modernization and mechanization of their agriculture, for providing irrigation facilities and for developing land.

The banks also extend their financial assistance in the areas of animal husbanding, dairy farming, sheep breeding, poultry farming and horticulture.

6. For improving the standard of living of the people

The standard of living of the people is estimated on the basis of the consumption pattern. The banks advance loans to consumers for the purchase of consumer durables and other immovable property, which will raise the standard of living of the people.

Stimulating human capital formation, facilitating monetary policy formulation and developing entrepreneurs are some of the other roles played by commercial banks in the economic life of every nation.

1.5 Reforms in Banking Sector

Q12. Explain the various reforms in banking sector.

(OR)

Discuss the extent to which recommendations of Narasimham committee (1991) have been implemented.

(OR)

Explain the major recommendations of Narasimham committee on review of financial sector reforms 1998.

Ans : **(Dec.-21, Oct.-20, May-19, Imp.)**

An efficient banking structure can promote greater amount of investment which can help to achieve a faster growth of the economy. In India, the year 1991 saw a drastic change in the economic policy of government. Liberalization, privatization, globalization emerged as vital parameters of growth and development. But at that time India was facing macro economic crisis.

1. The economy was growing at very low rate.
2. There were high non performing assets.
3. The customer service was unsatisfactory.
4. Banking system was not sound enough.
5. Poor financial condition of commercial banks.
6. The banks were lagging behind international standards in terms of computer technology, accounting standards and capital adequacy etc.

So government of India appointed a high level committee headed by Shri M. Narsimham a former governor of the reserve bank of India. Government of India set up two committees.

I) Narsimham committee on financial sector reform in 1991.

II) Narsimham committee on banking sector reform in 1998.

I) Recommendation of Narsimham committee on financial sector reform in 1991

i) **Reduction in CRR and SLR:** the Narsimham committee recommended reduction in CRR and SLR with a view to increase credit creation capacity of banks. SLR to be reduced to 25% over a period of five years and CRR from 15% to 5.5%.

ii) **Abolition of direct credit programmes**: – Narsimham committee recommended abolition of direct credit programme gradually. The priority sector should include farmers, tiny sectors, cottage industries, rural artisans and weaker sections.

iii) **Deregulate and lowering interest rate**: Narsimham committee recommended prime lending rate which will be the minimum lending rate by the banks.

iv) **Adoption of uniform accounting practices**: Narsimham committee recommended transparency regarding bank balance sheets and making full disclosures.

v) **Establishment of special tribunal** (asset reconstruction fund):- Tiwari committee suggested to set up special tribunal to speed up the process of recovery of loan and asset reconstruction fund should be set up to take off bad and doubtful debts from banks and financial institution at discount.

vi) **Reconstitution of banking system**: – Narsimham committee recommended reconstitution of banking system in a pattern of;

a) 3 or 4 large banks of international character.

b) 8 to 10 national banks with branches through out country engaged in universal banking.

c) Local banks with operation in specified region.

d) Rural banks should be confined to rural areas to provide agricultural finance.

vii) Abolition of branch licensing: Narsimham committee recommended abolition of branch licensing and leaving the matter of opening and closing of branch to individual banks. In case of nationalized banks 3 tier structures of head office, zonal office and branch is favored, local banks may have 2 tier and SBI may have 4 tier system.

viii) Computerization: On the recommendation of Rangrajan committee the Narsinham committee favored computerization.

ix) Ending of dual control: Duality of control by RBI and Ministry of finance should be ended. Only RBI should have control over the banks.

x) Capital adequacy norms: Narsinham committee recommended bank of international standards in phased manner. A capital adequacy ratio of 4% to be achieved by March 1993 and 8% by March 1996.

xi) Non performing assets: an asset is classified as Non Performing Assets if due in the form of principal and interest are not paid by the borrower for a period of 180 days. However, with a view to moving toward international best practices and to ensure greater transparency it has been decided to adopt the 90 days overdue norm for identification of Non Performing Assets from the year ending March 31, 2004. The committee recommended that assets should be classified into 4 categories; Standard, sub standard, doubtful, loss assets.

xii) Development financial institutions: Narsinham committee recommended regarding financial institutions that

a) Capital market should be liberalized.

b) The RBI should set up a new agency to supervise financial institutions.

II) Narsimham committee on banking sector reform in 1998.

It submitted its report to the Government in April 1998 with the following recommendations.

1. **Strengthening Banks in India :** The committee considered the stronger banking system in the context of the Current Account Convertibility 'CAC'. It thought that Indian banks must be capable of handling problems regarding domestic liquidity and exchange rate management in the light of CAC. Thus, it recommended the merger of strong banks which will have 'multiplier effect' on the industry.

2. **Narrow Banking:** Those days many public sector banks were facing a problem of the Non-performing assets (NPAs). Some of them had NPAs were as high as 20 percent of their assets. Thus for successful rehabilitation of these banks it recommended 'Narrow Banking Concept' where weak banks will be allowed to place their funds only in short term and risk free assets.

3. **Capital Adequacy Ratio:** In order to improve the inherent strength of the Indian banking system the committee recommended that the Government should raise the prescribed capital adequacy norms. This will further improve their absorption capacity also. Currently the capital adequacy ration for Indian banks is at 9 percent.

4. **Bank ownership:** As it had earlier mentioned the freedom for banks in its working and bank autonomy, it felt that the government control over the banks in the form of management and ownership and bank autonomy does not go hand in hand and thus it recommended a review of functions of boards and enabled them to adopt professional corporate strategy.

5. **Review of banking laws :** The committee considered that there was an urgent need for reviewing and amending main laws governing Indian Banking Industry like RBI Act, Banking Regulation Act, State Bank of India Act, Bank Nationalisation Act, etc. This upgradation will bring them in line with the present needs of the banking sector in India.

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

1.6 Global Financial Crisis & Indian Banking Sector

Q13. What do you mean by Global Financial Crisis. Explain the main causes of GFC.

Ans : **(Imp.)**

Meaning

The global financial crisis refers to the period of extreme stress in global financial markets and banking systems between mid 2007 and early 2009. During the global financial crisis, a downturn in US housing market was a catalyst for a financial crisis that spread from USA to the rest of the world through linkages in the global financial system. Many banks around the world incurred large losses and relied on government support to avoid bankruptcy. The economies worldwide slowed during this period was credit tightened and international trade declined.

Causes

1. **Excessive Risk Taking :** Economic conditions in USA and other countries were favourable in the years leading up to the global financial crisis. Economic growth was strong and stable, rates of inflation, unemployment and interest were relatively low. House prices grew strongly in this environment. Expectations that house prices would continue to rise led households to borrow money imprudently to buy and build house in USA. Many of the mortgage loans were for amounts close to the purchase price of a house or even above. A large share of such risky borrowing was done by investors seeking to make short-term profits by sub-prime borrowers.

2. **Increased Borrowing by Banks and Investors :** Banks and other investors in USA borrowed increasing amounts to expand their lending and purchase MBS (Mortgage Backed Securities). There are equal chances of potential profits as well as potential losses to use the borrowed money to purchase an asset. As a result, banks and investors incurred large losses when house prices began to fall because they had borrowed so much.

3. **Regulation and Policy Errors :** Regulations of sub-prime lending and mortgage-backed securities was not strict. In particular, there was insufficient regulation of the institutions that created and sold the complex and MBS to investors.

4. **Failure of Central Banks :** Many central banks and governments did not fully recognize the extent to which bad loans had been extended during the boonyand the many ways in which mortgage losses were spreading through the financial system.

Q14. Explain the impact of global Global Financial Crisis on Indian Banking Sector.

Ans :

When the entire banking and financial system around the world got collapsed and adversely affected due to the global financial crisis, Indian banking system managed to maintain its position. Due to the stringent regulations and efficient monitoring system, Indian banks were not directly exposed to the sub-prime mortgaged assets, derivatives and off balance sheet activities. There were no direct exposures of Indian banks to the US sub-prime mortgage market, credit default swap market, to the failed institutions and stressed assets. During this time, the total share of bank assets held by foreign banks in India was around 5%. It was almost at the lowest level in comparison with that of other countries. The lending practices adopted by the Indian bank were also prudent in their lending practices in the real estate sector.

Banks were generally issued mortgaged loans and avoided sub-prime mortgage loans.

1. **Stress on Banks** : Indian banking sector faced the stress because foreign investors pulled out of the economy. It created a liquidity crunch.
2. **Cautious Lending** : The tightened global liquidity situation in the period immediately following the failure of Lehman Brothers. It did on top of a turn in the credit cycle, increased the risk aversion of the financial system and made banks cautious about lending.
3. **Redemption Pressure** : Corporate and retail investors exerted redemption pressures on mutual funds, some of which got transmitted to NBFC's due to their dependence for funds on mutual hands.
4. **Deposit Growth** : The deposit growth of commercial banks decelerated marginally during 2008-09 as compared to previous year.
5. **Bank Credit** : The growth in bank credit decelerated at a faster rate than deposits during 2008-09.
6. **Loans and Advances Growth :** Loans and advances of commercial banks have been growing, driven largely by targeted lending to priority sector which includes agriculture, micro and small enterprises, micro credit, education and housing.
7. **Profitability :** The profitability of Indian banks was maintained during the year of the crisis. The Return on Assets (ROA) during 2008-09 remained at the level of last year of about 1.13%. It reduces moderately to 1.05% in 2009-10.
8. **CRAR :** The CRAR of scheduled commercial banks slipped back to 1.13% at end March 2011 after improving from 13.0% as at end March 2008 to 13.6% as at end March 2010.
9. **Non-Performing Assets Ratio :** The gross NPA ratio of scheduled commercial banks remained intact during the crisis year at 2.3%. As at end March 2009 and end March 2008, it increased moderately to 2.39%.
10. **Use of CRR and SLR** : RBI uses cash reserve ratio and statutory liquidity ratio together with a wide range of other measure to ensure a robust liquidity back stop. The relatively high level of SLR set at 24% of net time and deposit liabilities in addition to CRR set at 6% have enabled banks to cope well with liquidity pressures during the recent global financial crisis.

Q15. Explain the measures taken by RBI to control the financial crisis in India.

Ans :

RBI had taken several measures to control the impact of global financial crisis in India after the global melt down in the year 2008.

1. **Special Action Plan** : RBI prepared and executed an action plan to infuse rupee and foreign exchange liquidity to ensure smooth flow of credit to productive sectors of the economy.
2. **Reduction in Repo Rate** : The repo rate was reduced by RBI to 4.75%.
3. **Reduction in Reverse Repo Rate** : The reverse repo rate was reduced by RBI to 3.25%.
4. **Reduction in CRR** : The cash reserve ratio was reduced to 5.0%.
5. **Special Repo Window** : RBI introduced a special repo window under the liquidity adjustment facility.
6. **Special Refinance Facility** : RBI provided a special refinance facility to the banks for their easy access without any collateral.

7. **Market Stabilization Scheme** : A strategic decision was taken by RBI to introduce the market stabilization scheme securities helped in synchronization of the entire lending system of the government for managing liquidity.

8. **Capital Adequacy Ratio :** RBI had raised the capital adequacy ratio from 8% to 9% for existing banks and to 10% for new private sector banks and banks undertaking insurance business.

9. **Rupee-Dollar Swap Facility** : RBI had incorporated a rupee dollar swap facility for banks with foreign bank branches with the objectives to manage their short-term funding requirements.

Q16. Explain the various challenges of Global Financial Crisis and Indian Banking Sector.

Ans : **(Imp.)**

The following are the major challenges facing the banking system in the country, particularly in the wake of the global financial crisis:

I) Maintaining the Credit Flow

The outlook, both for the world and for India, continues to remain uncertain. The future trajectory of the global crisis is not yet clear. The year 2009-10 remained more challenging one. There was a noticeable decline in the credit demand in the month of November 2008 but it is not yet clear if it was a one off episode or it reflects a trend. If it is indicative of slowing economic activity, it would be a major challenge for the banks to ensure healthy flow of credit to the productive sectors of the economy. The economic growth, even in normal times, requires efficient financial intermediation. An economic downturn, therefore, requires even more efficient financial intermediation – and this is a major challenge that the banking community has to address. There is a need to ensure a steady credit flow to the real sector of the economy in order to sustain demand even while maintaining credit quality.

II) How Do We Reform Financial Sector Regulation?

By far, the most contentious and most voluble debate triggered by the crisis has been about the flaws in the regulatory architecture of the financial sector. Several issues have come to the fore which includes: How can complex derivative products, which transmitted risks across the system, be made more transparent? What are the financial stability implications of structured products like credit derivatives? Are exchange traded derivatives better than over-the-counter (OTC) derivatives? How do we eliminate the drawbacks of the 'originate-to- distribute' model? Is universal banking, the model that the United States has now turned to, appropriate? Can the same regulatory regime can be applied for both wholesale and retail banks?

The burden of all the above questions is to identify the drawbacks in the present regulatory regimes and indicate possible solutions. The first thing to remember is that no one size fits all curve. There is no denying that regulations have to keep pace with innovations in the financial markets but in doing so, we must be mindful of the risks of over-tightening the regulations lest they stifle innovation.

III) Regulatory Forbearance and Relaxing Regulatory Norms

There has been a sustained demand from various quarters for exercising regulatory forbearance in regard to extant prudential regulations applicable to the banking sector. As a part of counter-cyclical package, several changes have already made to the current prudential norms. These include:

(a) reduction in the risk weights for claims on unrated corporate and commercial real estate to 100 per cent;

(b) reduction in the provisioning requirement for all standard assets to 0.40 per cent;

(c) permitting housing loans to be restructured even if the revised payment period exceeds ten years;

(d) making the restructured commercial real estate exposures eligible for special treatment if restructured before June 30, 2009.

IV) Effective Implementation of Basel II Framework

A part of the Indian banking system has already migrated to the Basel II Framework effective March 31, 2008 and the remaining commercial banks are slated to do so by March 31, 2009. However, having regard to the state of preparedness of the system, for the present, only the simpler approaches available under the Framework has been adopted. The RBI is yet to announce the timeframe for adoption of the Advanced Approaches in the Indian banking system but the migration to these Approaches is the eventual goal – for which the banking system will need to start its preparations in all earnestness.

V) The Challenge of Banking Development and Financial

Banking development in the eastern region of the country, as measured by several parameters, is lagging behind the national average. In terms of infrastructure coverage and other development indicators, the eastern region is not as developed as other regions of the country. Admittedly, this affects the credit absorption capacity and may also explain some of the lagging parameters mentioned above. However, this can not be an excuse for inaction. It should be impetus for vigorous action.

Short Question and Answers

1. Lender of the Last Resort

Ans :

As the banker to the banks, RBI acts as the lender of the last report and grants accommodation to the scheduled banks in the following forms;

i) Rediscounting or purchase of eligible bills, Section 17(2) & (3)

ii) Loans and advances against certain securities, Section 17(4)

iii) Rediscounting of Bills. Section 17(2) lays down that the following categories of bill are eligible for rediscounting with the Reserve Bank.

- Commercial Bills
- Bill of Financing Agricultural Operations.
- Bill of financing cottage and small-scale industries.
- Bill of holding or trading in Government Securities.
- A foreign bill.

2. Define the term banker.

Ans :

i) According to Banking Regulations Act, 1949, Section 5(b): Banking is defined as "accepting for the purpose of lending or investments of deposits of money received from the public and repayable on demand and withdrawable by cheque, draft, order or otherwise". Thus, the term banker is not defined by B R Act but it defines the term "Banking". This definition highlights two points:

1. The primary function of a banker is accepting of deposits for the purpose of lending or investing the same;

2. The amount deposited is repayable to the depositor on demand or according to the agreement. The demand for repayment can be made through a cheque, draft or otherwise, and not merely by verbal order. Let us see some definitions of Banker.

ii) According to Dr. Herbert L. Heart, "A Banker is one who in the ordinary course of business honours cheques drawn upon him by any persons from and for whom he receives money on current accounts".

iii) According to Sec. 3 of the Indian Negotiable Instruments Act 1881, the word "banker includes any person acting as banker and any post office savings bank".

iv) According to Sec. 2 of the Bill of Exchange Act, 1882, 'banker includes a body of persons, whether incorporated or not who carry on the business of banking.'

3. Define the term 'Customer'.

Ans :

The term 'Customer' is not defined by any act either in India or in English Statutes. The word 'customer' has its origin from the word 'custom', which means a 'habit or tendency' to-do certain things in a regular or a particular manner. Generally speaking, a customer is one who has an account with the bank or who utilizes the services of the bank.

Account relationship is a contractual relationship. It is generally believed that any individual or an organization, which conducts banking transactions with a bank, is the customer of bank. However, there are many persons who do utilize services of banks, but do not maintain any account with the bank. Therefore, bank customers can be conveniently classified into four types. They are :

(a) Existing customers

(b) Former customers

(c) Customers for services like Demand Draft purchase, cheque encasement, etc.

(d) Potential customers

Definition

According to Pirvu, "Customers are bank depositors, who entrust their money, banking facilities, for storage and fruiting, for which they receive interest and applicants or those who need temporary, some additional money for paying interest or commission".

4. Bank.

Ans :

The word 'Bank' has been derived from the Latin word 'bancus' or 'banque'. The meaning of it in English is a bench. The early bankers transacted their business at benches in a market place. According to some authorities, the word bank was originally derived from German word bank. It means a joint stock fund. This word later on was called as 'banco' in Italy when a great part of Italy was ruled by the Germans.

A bank is a financial institution which deals with deposits and advances and other related services. It receives money from those who want to save in the form of deposits and it lends money to those who need it. A bank is a financial institution and a financial intermediary that accepts deposits and channels those deposits into lending activities, either directly by loaning or indirectly through capital markets. A bank is the connection between customers that have capital deficits and customers with capital surpluses.

Definitions

i) **F.E. Perry :** "The bank is an establishment which deals in money, receiving it on deposit from customers, hounouring customer's drawings against such deposits on demand, collecting cheques for customes and lending or investing surplus deposits until they are required for repayment."

ii) **Walter Leaf :** "A banker is an institution or individual who is always ready to receive money on deposits to be returned against the cheques of their depositors."

iii) **Dr. Herbert L. Hart :** "A banker is one who in the ordinary course of his business, honours cheques drawn upon him by persons from and for whom he receives money on current accounts."

iv) **The Indian Banking Companies Act, 1949 :** "Banking means the acceptance for the purpose of lending or investment, of deposits of money from the public repayable on demand or otherwise, and withdrawal by cheque, draft, order or otherwise".

5. Advancing Loans

Ans :

The second main function of the commercial bank is to advance loans. Money is lent to businessmen and trade for short period only. These banks cannot lend money for long period because they must keep themselves ready to meet the short term deposits. The bank advances money in any one of the following forms :

a) **Cash Credit :** Cash Credit is a type of advance wherein a banker permits his customer to borrow money upto a particular limit by a bond of credit with one or more securities. The advantage associated with this system is that a customer can withdrawn money as and when required. The bank will charge interest only on the actual amount withdrawn by the customer. Many industrial concerns and business houses borrow money in this form.

b) **Overdraft :** An overdraft is an arrangement by which the customer is allowed to overdraw his account. It is granted against some collateral securities. The facility to overdraw is allowed through current account only. Interest is charged on the exact amount of overdrawn subject to the payment of minimum amount by way of interest.

c) **Loan :** Loan is an advance in lump sum amount the whole of which is withdrawn and is supported to be rapid generally wholly at one time. It is made with or without security. It is given for a fixed period at in agreed rate of interest. Repayments may be made in installments or at the expiry of a certain period.

d) **Discounting Bill of Exchange:** The bank also gives advances to their customers by discounting their bills. The net amount after deducting the amount of discount is credited to the account of customer. The bank may discount the bills with or without any security from the debtor in addition to the personal security of one or more person already liable on the bill.

6. Agency Services

Ans :

Modern Banks render service to the individual or to the business institutions as an agent. Banks usually charge little commission for doing these services. These services are as follows:

a) **Remittance of Funds:** Banks help their customers in transferring funds from one place to another through cheques, drafts etc.

b) **Collection and Payment of Credit Instruments:** Banks collects and pays various credit instruments like cheques, bill of exchange, promissory notes etc.

c) **Purchasing and Sale of Securities:** Banks undertake purchase and sale of various securities like shares, stocks, bonds, debentures etc. on behalf of their customers. Banks neither give any advice to their customers, regarding this investment, nor levy any charge of them for their services, but simply perform the function of a broker.

d) **Income Tax Consultancy:** Sometimes bankers also employ income tax experts not only to prepare income tax returns for their customer but to help them to get refund of income tax in appropriate cases.

e) **Acting as Trustee and Executor :** Banks preserve the wills of their customers and execute them after their death.

f) **Acting as Representatives and Correspondent :** Sometimes the banks act as representatives and correspondents of their customers. They get passports, travelers tickets secure passages for their customers and receive letters on their behalf.

7. Objectives of RBI

Ans :

The important objectives are:

1. **To act as Monetary Authority**

   Formulates implements and monitors the monetary policy to maintain price stability and ensuring adequate flow of credit to productive sectors.

2. **To Regulate and supervise the financial system of the country**

   It prescribes broad parameters of banking operations within which the country's banking and financial system functions. It helps to maintain public confidence in the system, protect depositors' interest and provide cost-effective banking services to the public.

3. **To Manage the Exchange Control**

   Manages the Foreign Exchange Management Act, 1999 to facilitate external trade and payment and promote orderly development and maintenance of foreign exchange market in India.

4. **To Issue Currency**

   Issues and exchanges or destroys currency and coins not fit for circulation to give the public adequate quantity of supplies of currency notes and coins and in good quality.

5. **To Undertake Developmental Role**

   RBI performs a wide range of promotional functions to support national objectives.

6. **To undertake related Functions by acting as**

   - Banker to the Government: performs merchant banking function for the central and the state governments; also acts as their banker.
   - Banker to banks: maintains banking accounts of all scheduled banks.
   - Owner and operator of the depository (SGL-Subsidiary General Ledger account) and exchange (NDS).

8. Bankers Bank

Ans :

RBI is the banker to the banks – Commercial, Co-operative & Regional Rural Banks (RRBs). This relationship is established once the name of a bank is included in the second schedule to the RBI Act, 1934. Such banks are called scheduled banks. The category of scheduled banks includes.

i) Commercial Banks – Indian and foreign

ii) Regional Rural Banks &

iii) State Co-operative Banks

A **'Schedule Bank'** means a bank included in the second schedule to the RBI Act, 1934. The Reserve Bank is empowered to include in the second schedule the name of a bank, which carries on the business of banking in India and which satisfies the following conditions laid down in section 42(6):

i) It must have a paid-up capital and reserve of an aggregate value of not less than Rs.5 lakhs;

ii) It must satisfy RBI that its affairs are not being conducted in a manner deter-mined to the interest of its depositors, and

iii) It must be;

- A state co-operative bank or
- A company as defined in the companies act, 1956, or

iv) An institution notified by the central government in the behalf, or

v) A corporation or a company incorpo-rated by or under any law in force in any place outside India.

9. Bank of Note Issue

Ans :

The currency of our country consists of one-rupee notes and coins (including subsidiary coins) issued by the government of India and bank note issued by RBI. As required by Section 38 of RBI Act, government puts into circulation one rupee coins & notes through RBI only. RBI has the sole right to issue bank notes in India. The notes issued by RBI and the one-rupee notes & coins issued by the government are unlimited legal tender. RBI also bears the responsibility of exchanging notes & coins into those of other denominations as required by the public.

The assets of the Issue Department against which bank notes are issued consist of the following:

- Gold Coins & Bullion
- Foreign Securities
- Rupee Coins
- Government of India Rupee Securities
- The bill of exchange and promissory notes payable in India, which are eligible for purchase by the Bank.

10. Promotional Functions

Ans :

With economic growth assuming a new urgency since Independence, the range of RBI's function has steadily widened. The Bank now performs a variety of developmental & promotional functions. Which at one time were regarded as outside the normal scope of central banking. RBI was asked to promote banking habit, extend banking facilities to rural and semi-urban areas, & establish & promote new specialized agencies.

Accordingly, RBI has helped in the setting up of IFCI and SFCs; it set up the Deposit Insurance Corporation in 1962, the Unit Trust of India in 1964, the industrial Development Bank of India also in 1964, the Agricultural Re-finance Corporation of India in 1963, the Industrial Re-constructions Corporation of India in 1972 & NABARD in 1982. These institutions were set up directly or indirectly by RBI to promote savings habit and to mobilize savings, to provide industrial finance as well as agriculture finance.

11. Global Financial Crisis

Ans :

The global financial crisis refers to the period of extreme stress in global financial markets and banking systems between mid 2007 and early 2009. During the global financial crisis, a downturn in US housing market was a catalyst for a financial crisis that spread from USA to the rest of the world through linkages in the global financial system. Many banks around the world incurred large losses and relied on government support to avoid bankruptcy. The economies worldwide slowed during this period was credit tightened and international trade declined.

12. Commercial Bank

Ans :

Commercial Banks are business enterprises which are involved in finances, financial instruments and provide financial services for a price which maybe in the form of interest, commission or a discount and so on. "They accept deposits of money from the public (savings), for the purpose of lending or investment (to meet working capital requirements or corporates)".

13. What are Nationalized Banks.

Ans :

Banks are nationalised under the banking companies Act, 1970. This phase constitutes the second stage of nationalisation. In 1969, nearly fourteen big Indian joint stock banks belonging to the private sector undergone the nationalisation process. During the third stage of nationalisation, six commercial banks in the private sector with an average deposits of over ` 200 crores were nationalised on August 15, 1980. Presently, there are 27 nationalised Banks, the state bank of India and its six associates and 19 nationalized banks and IDBI.

Choose the Correct Answer

1. The Reserve Bank of India was established on ________. [a]
   (a) April 1, 1935 (b) July 12, 1982
   (c) May 26, 2006 (d) September 30, 2005
2. Who works as RBI's agent at places where it has no office of its own? [a]
   (a) State Bank of India (b) Ministry of Finance
   (c) Government of India (d) International Monetary Fund
3. Which among the following is incorrect? [d]
   (a) RBI is the Bank of Issue (b) RBI acts as Banker to the Government
   (c) RBI is Banker's Bank (d) RBI does not regulate the flow of credit
4. Which among the following is not a public sector bank? [b]
   (a) Allahabad Bank (b) City Union Bank
   (c) UCO Bank (d) Vijaya Bank
5. Which is the largest commercial bank of the country? [c]
   (a) Bank of India (b) Canara Bank
   (c) State Bank of India (d) Union Bank of India
6. When did the nationalization of major banks happen? [d]
   (a) June, 1951 (b) June, 1961
   (c) June, 1969 (d) July, 1969
7. The primary objective of the banking sector is ________. [c]
   (a) Accepting deposits (b) Lending loans
   (c) A and B (d) None
8. Presidency banks merged in ________ year. [c]
   (a) 1932 (b) 1936
   (c) 1921 (d) 1946
9. Section ________ deals with banking regulation Act, 1949. [b]
   (a) 5(a) (b) 5(b)
   (c) 5(e) (d) 5(g)
10. In a general scenario a customer need to perform many ________ transactions to term a customer of a bank. [a]
    (a) 32 (b) 42
    (c) 46 (d) 58

Fill in the Blanks

1. A ________ is a financial institution which deals with deposits and advances and other related services.
2. The most important function of commercial banks is to ________.
3. The ________ is the apex financial institution of the country's financial system.
4. ________ is also known as online banking
5. ________ refers to the process of carrying out any banking transaction through internet with help of mobile phone.
6. ________ scheme has been formulated by Reserve Bank of India for providing service to the Bank clients.
7. ________ play a very useful and crucial role in the economic life of every nation.
8. GFC stands for ________.
9. RBI stands for ________.
10. The second main function of the commercial bank is to ________.

Answers

1. Bank
2. Accept deposits from public
3. Reserve Bank of India
4. E-Banking
5. Mobile banking
6. Banking Ombudsman
7. Banks
8. Global Financial Crisis
9. Reserve Bank of India
10. Advance loans

UNIT II	**RBI AND TYPES OF BANKS:** RBI, Constitution, Organizational Structure Management, Objectives, Functions, monetary Policy. Dist Cooperative Central Bank, RRB, NABARD, IDBI, SIDBI, Development Banks.

2.1 RBI

2.1.1 Constitution, Organizational Structure

Q1. What is RBI ? Explain the organizational structure of RBI.

Ans : **(Imp.)**

The RBI Act, 1934 is a primary legislation for regulating banking services in India. The Reserve Bank of India is given the authority to control all banks from their establishment till their windup. It is monopoly bank.

Establishment

Reserve Bank of India (RBI) is the central bank of India. It came in to reality after many difficulties. Imperial Bank of India founded in 1921 was considered as the leader of Indian banks. Any way RBI came in to reality by the passing of Reserve Bank of India Act in 1934 and started its functions from 1935.

At the beginning of the RBI, it was owned by private individuals with government. Finally in 1948 the central government become the whole owner of RBI.

Today, economic system should be favor, then only they can shine before other nations. So, it is very essential for a central bank to deal with the financial resources of the country. RBI is the one of the strongest central bank performing many functions.

Organizational Structure of RBI

The affairs of the bank are controlled by a central board of directors, The central board consists of the following members,

1. One governor and not more than four deputy governors appointed by the central government for such periods not exceeding five years as may be fixed by the central government at the time of their appointment.

2. Four directors nominated by central government one each of the four local boards. The term of office of the directors is related to their membership in the local boards.

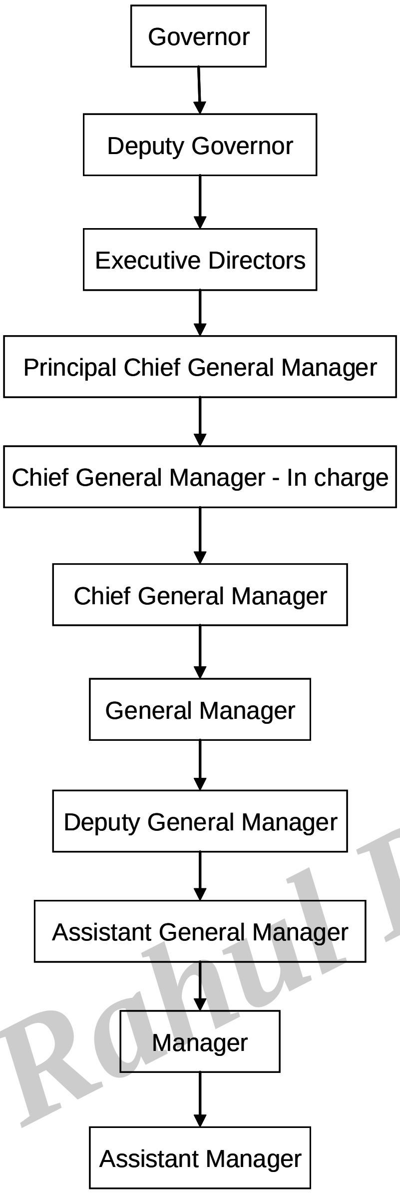


Fig.: Structure of RBI

3. The other ten directors are nominated by central government These directors hold office for four years and there is provision in the Act for their retirement by rotation.

4. One government official to be nominated by the central government. He/she shall hold office during the pleasure of the central government.

Besides the central board, there are local boards for the four regions of the country with headquarters at Mumbai, Calcutta, Chennai and Delhi. Local board consists of five members appointed by central government for a term of four years to represent as well as possible territorial and economic interests as well as interests of the cooperative and indigenous banks. The functions of the local boards are to advise the central board on such matters as may generally or specifically be referred to them and to perform such duties as the central board may by regulations delegate to them.

2.1.2 Objectives and Management

Q2. Describe the objectives of RBI.

Ans :

i) The Preamble to the Reserve Bank of India Act, 1934 spells out the objectives of the Reserve Bank as: "to regulate the issue of Bank notes and the keeping of reserves with a view to securing monetary stability in India and generally to operate the currency and credit system of the country to its advantage."

ii) Prior to the establishment of the Reserve Bank, the Indian financial system was totally inadequate on account of the inherent weakness of the dual control of currency by the Central Government and of credit by the Imperial Bank of India.

iii) The Hilton-Young Commission, therefore, recommended that the dichotomy of functions and division of responsibility for control of currency and credit and the divergent policies in this respect must be ended by setting-up of a central bank – called the Reserve Bank of India – which would regulate the financial policy and develop banking facilities throughout the country. Hence, the Bank was established with this primary object in view.

iv) Another objective of the Reserve Bank has been to remain free from political influence and be in successful operation for maintaining financial stability and credit.

v) The fundamental object of the Reserve Bank of India is to discharge purely central banking functions in the Indian money market, i.e., to act as the note- issuing authority, bankers' bank and banker to government, and to promote the growth of the economy within the framework of the general economic policy of the Government, consistent with the need of maintenance of price stability.

vi) A significant object of the Reserve Bank of India has also been to assist the planned process of development of the Indian economy. Besides the traditional central banking functions, with the launching of the five-year plans in the country, the Reserve Bank of India has been moving ahead in performing a host of developmental and promotional functions, which are normally beyond the purview of a traditional Central Bank.

Q3. Explain the Management of RBI.

Ans :

The management of RBI is divided into two parts, they are,

1. Central Board of Directors
2. Local Boards.

1. Central Board of Directors

The RBI is controlled by central board of directors which comprises of 20 members.

(i) One governor and four deputy governors are nominated by the central government from ministry of finance as per the Reserve Bank of India for 4 years.

(ii) Four directors appointed by the central government under section 8(I(b)). Four zones (N, E, W, S) from various interest experts

(iii) Ten directors appointed by the central government under section 8(I(c)).

(iv) Control boards head quarters is in Mumbai, local board is in Chennai, Kolkata.

(v) The governor is the chairman of Central Board of Directors of the RBI. In governor's absence, the Deputy Governor is appointed to exercise the powers of governor.

2. Local Boards

The local boards of RBI consist of five members, appointed by the central government for a four year term. The members of each local board elects their own chairman. The local boards represent economic and territorial interest and the interest of cooperatives and indigenous banks. These local boards has limited powers?".

2.1.3 Functions

Q4. Explain the functions of RBI.

Ans :

For answer refer Unit-I, Q.No. 9.

2.2 Monetary Policy

Q5. Define Monetary Policy. What are the objectives of Monetary Policy?

Ans :

Meaning

Monetary policy refers to the process by which the monetary authority of a country controls the supply of money, often targeting a rate of interest to attain a set of objectives oriented towards the growth and stability of the economy.

Definitions

Many economists have given various definitions of monetary policy. Some prominent definitions are as follows:

i) **According to Prof. Harry Johnson,** "Monetary policy is a policy employing the central banks control of the supply of money as an instrument for achieving the objectives of general economic policy is a monetary policy."

ii) **According to A.G Hart,** "Monetary policy is a policy which influences the public stock of money substitute of public demand for such assets of both that is policy which influences public liquidity position is known as a monetary policy."

Objectives

The objectives of a monetary policy in India are similar to the objectives of its five year plans. In a nutshell planning in India aims at growth stability and social justice. After the Keynesian revolution in economics, many people accepted significance of monetary policy in attaining following objectives:

i) **To ensure the Rapid Economic Growth**

It is the most important objective of a monetary policy. The monetary policy can influence economic growth by controlling real interest rate and its resultant impact on the investment. If the RBI opts for a cheap or easy credit policy by reducing interest rates, the investment level in the economy can be encouraged. This increased investment can speed up economic growth. Faster economic growth is possible if the monetary policy succeeds in maintaining income and price stability.

ii) To helps for Price Stability

All the economics suffer from inflation and deflation. It can also be called as Price Instability. Both inflations are harmful to the economy. Thus, the monetary policy having an objective of price stability tries to keep the value of money stable. It helps in reducing the income and wealth inequalities. When the economy suffers from recession the monetary policy should be an 'easy money policy' but when there is inflationary situation there should be a 'dear money policy'.

iii) To assists for Exchange Rate Stability

Exchange rate is the price of a home currency expressed in terms of any foreign currency. If this exchange rate is very volatile leading to frequent ups and downs in the exchange rate, the international community might lose confidence in our economy. The monetary policy aims at maintaining the relative stability in the exchange rate. The RBI by altering the foreign exchange reserves tries to influence the demand for foreign exchange and tries to maintain the exchange rate stability.

iv) To assists for Balance of Payments (BOP) Equilibrium

Many developing countries like India suffer from the Disequilibrium in the BOP. The Reserve Bank of India through its monetary policy tries to maintain equilibrium in the balance of payments. The BOP has two aspects i.e. the 'BOP Surplus' and the 'BOP Deficit'. The former reflects an excess money supply in the . Domestic economy, while the later stands for stringency of money. If the monetary policy succeeds in maintaining monetary equilibrium, then the BOP equilibrium can be achieved.

v) To ensure the Full Employment

The concept of full employment was much discussed after Keynes's publication of the "General Theory" in 1936. It refers to absence of involuntary unemployment. In simple words 'Full Employment' stands for a situation in which everybody who wants jobs get jobs. However it does not mean that there is Zero unemployment. In that senses the full employment is never full. Monetary policy can be used for achieving full employment. If the monetary policy is expansionary then credit supply can be encouraged. It could help in creating more jobs in different sector of the economy.

vi) To ensure the Neutrality of Money

Economist such as Wicksted, Robertson has always considered money as a passive factor. According to them, money should play only a role of medium of exchange and not more than that. Therefore, the monetary policy should regulate the supply of money. The change in money supply creates monetary disequilibrium. Thus monetary policy has to regulate the supply of money and neutralize the effect of money expansion. However this objective of a monetary policy is always criticized on the ground that if money supply is kept constant then it would be difficult to attain price stability.

vii) To support for Equal Income Distribution

Many economists used to justify the role of the fiscal policy is maintaining economic equality. However in recent years economists have given the opinion that the monetary policy can help and play a supplementary role in attainting an economic equality. Monetary policy can make special provisions for the neglect supply such as agriculture, small-scale industries, village industries, etc. and provide them with cheaper credit for longer term. This can prove fruitful for these sectors to come up. Thus in recent period, monetary policy can help in reducing economic inequalities among different sections of society.

Q6. Explain different types of Monetary Policy?

Ans : **(Imp.)**

1. Inflation targeting

Under this policy approach the target is to keep inflation, under a particular definition such as Consumer Price Index, within a desired range.

The inflation target is achieved through periodic adjustments to the Central Bank interest rate target. The interest rate used is generally the interbank rate at which banks lend to each other overnight for cash flow purposes. Depending on the country this particular interest rate might be called the cash rate or something similar.

The interest rate target is maintained for a specific duration using open market operations. Typically the duration that the interest rate target is kept constant will vary between months and years. This interest rate target is usually reviewed on a monthly or quarterly basis by a policy committee.

Changes to the interest rate target are made in response to various market indicators in an attempt to forecast economic trends and in so doing keep the market on track towards achieving the defined inflation target.

2. Price level targeting

Price level targeting is similar to inflation targeting except that CPI growth in one year over or under the long term price level target is offset in subsequent years such that a targeted price-level is reached over time, e.g. five years, giving more certainty about future price increases to consumers. Under inflation targeting what happened in the immediate past years is not taken into account or adjusted for in the current and future years.

3. Monetary' aggregates

In the 1980s, several countries used an approach based on a constant growth in the money supply. This approach was refined to include different classes of money and credit (MO, MI etc.). While most monetary policy focuses on a price signal of one form or another, this approach is focused on monetary quantities.

4. Fixed exchange rate

Monetary policy is based on maintaining a fixed exchange rate with a foreign currency. There are varying degrees of fixed exchange rates, which can be ranked in relation to how rigid the fixed exchange rate is with the anchor nation.

Under a system of fiat fixed rates, the local government or monetary authority declares a fixed exchange rate but does not actively buy or sell currency to maintain the rate. Instead, the rate is enforced by non-convertibility measures (e.g. capital controls, import/export licenses, etc.). In this case there is a black market exchange rate where the currency trades at its market/unofficial rate.

Under a system of fixed-convertibility, currency is bought and sold by the central bank or monetary authority on a daily basis to achieve the target exchange rate. This target rate may be a fixed level or a fixed band within which the exchange rate may fluctuate until the monetary authority intervenes to buy or sell as necessary to maintain the exchange rate within the band. Under a system of fixed exchange rates maintained by a currency board every unit of local currency must be backed by a unit of foreign currency (correcting for the exchange rate). This ensures that the local monetary base does not inflate without being backed by hard currency and eliminates any worries about a run on the local currency by those wishing to convert the local currency to the hard (anchor) currency.

These policies often abdicate monetary policy to the foreign monetary authority or government as monetary policy in the pegging nation must align with monetary policy in the anchor nation to maintain the exchange rate. The degree to which local monetary policy becomes dependent on the anchor nation depends on factors such as capital mobility, openness, credit channels and other economic factors.

5. Gold standard

The gold standard is a system under which the price of the national currency is measured in units of gold bars and is kept constant by the government's promise to buy or sell gold at a fixed price in terms of the base currency. The gold standard might be regarded as a special case of "fixed exchange rate" policy, or as a special type of commodity price level targeting.

The minima! gold standard would be a long-term commitment to tighten monetary policy enough to prevent the price of gold from permanently rising above parity. A full gold standard would be a commitment to sell unlimited amounts of gold at parity and maintain a reserve of gold sufficient to redeem the entire monetary base.

Today this type of monetary policy is no longer used by any country, although the gold standard was widely used across the world between the mid-19th centuries through 1971. Its major advantages were simplicity and transparency. The gold standard was abandoned during the Great Depression, as countries sought to reinvigorate their economies by increasing their money supply. The Bretton Woods system, which was a modified gold standard, replaced it in the aftermath of World War II. However, this system too broke down during the Nixon shock of 1971.

Q7. Explain different tools of Monetary Policy?

Ans : **(Imp.)**

1. Monetary base

Monetary policy can be implemented by changing the size of the monetary base. Central banks use open market operations to change the monetary base. The central bank buys or sells reserve assets (usually monetary instruments such as bonds) in exchange for money on deposit at the central bank. Those deposits are convertible to currency. Together such currency and deposits constitute the monetary base which is the general liabilities of the central bank in its own monetary unit. Usually other banks can use base money as a fractional reserve and expand the circulating money supply by a larger amount.

2. Reserve requirements

The monetary authority exerts regulatory control over banks. Monetary policy can be implemented by changing the proportion of total assets that banks must hold in reserve with the central bank. Banks only maintain a small portion of their assets as cash available for immediate withdrawal; the rest is invested in illiquid assets like mortgages and loans. By changing the proportion of total assets to be held as liquid cash, the Federal Reserve changes the availability of loan able funds. This acts as a change in the money supply. Central banks typically do not change the reserve requirements often because it creates very volatile changes in the money supply due to the lending multiplier.

3. Discount window lending

Discount window lending is where the commercial banks/and other depository institutions, are able to borrow reserves from the Central Bank at a discount rate. This rate is usually set below short term market rates. This enables the institutions to vary credit conditions (i.e., the amount of money they have to loan out), thereby affecting the money supply. It is of note that the Discount Window is the only instrument which the Central Banks do not have total control over.

By affecting the money supply, it is theorized, that monetary policy can establish ranges for inflation, unemployment, interest rates and economic growth. A stable monetary environment is created in which savings and investment can occur, allowing for the growth of the economy as a whole.

4. Interest rates

The contraction of the monetary supply can be achieved indirectly by increasing the nominal interest rates. Monetary authorities in different nations have differing levels of control of economy- wide interest rates. One cannot set independent targets for both the monetary base and the interest rate because they are both modified by a single tool open market operations; one must choose which one to control. In other nations, the monetary authority may be able to mandate specific interest rates on loans, savings accounts or other monetary assets. By raising the interest rate(s) under its control, a monetary authority can contract the money supply, because higher interest rates encourage savings and discourage borrowing. Both of these effects reduce the size of the money supply.

5. Currency board

A currency board is a monetary arrangement that pegs the monetary base of one country to another, the anchor nation. As such, it essentially operates as a hard fixed exchange rate, whereby local currency in circulation is backed by foreign currency from the anchor nation at a fixed rate. Thus, to grow the local monetary base an equivalent amount of foreign currency must be held in reserves with the currency board. This limits the possibility for the local monetary authority to inflate or pursue other objectives. The principal rationales behind a currency board are threefold:

i) To import monetary credibility of the anchor nation;

ii) To maintain a fixed exchange rate with the anchor nation;

iii) To establish credibility with the exchange rate (the currency board arrangement is the hardest form of fixed exchange rates outside of dollarization).

In theory, it is possible that a country may peg the local currency to more than one foreign currency; although, in practice this has never happened (and it would be a more complicated to run than a simple single-currency currency board). A gold standard is a special case of a currency board where the value of the national currency is linked to the value of gold instead of a foreign currency.

Q8. What are the various challenges of monetary policy.

Ans :

1. Financial markets are unperturbed; with the flattening of yield curves, the compression of risk spreads and the search for yields continues unabated.

2. Global imbalances have actually increased with no fears of hard landing, but with some sense of readying for a bumpy soft landing. Movements in major exchange rates are not reflecting fundamentals in an environment of generalized elevation in asset prices and abundant liquidity.

3. Strong global economic growth could be accompanied by emerging pressures on core inflation. The challenge facing us is to judge the compatibility of the current pace of growth with non-accelerating inflation. In the event of a judgment that the current growth momentum is more cyclical than structural, the stance of monetary policy would need to reflect sensitivity to the inevitability of a downturn. On the other hand, the judgment that structural factors predominate would warrant a different policy stance.

4. An overriding concern faced by the Reserve Bank is the persistently high growth of bank credit, with attendant worries relating to the quality of bank credit The sharp increase in credit to sectors such as housing, commercial real estate and retail loans have also been worrisome on account of the vulnerability of banks to credit concentration risks.

5. It is difficult to arrive at a clear judgment as to what rate of credit growth is too high in relation to potential growth.

6. Some of the models integrate policy behavior with the banking system, the demand for a broad monetary aggregate, and a rich array of goods and financial market variables, providing a more complete understanding of the monetary transmission mechanism. Weak economic assumptions and large models combine to reveal difficulties with sorting out policy effects that other approaches fail to bring out.

2.3 District Central Cooperative Bank (DCCB)

Q9. What is District Central Cooperative Bank (DCCB)? Explain the functions of DCCB.

Ans :

Introduction

The initial co-operative legal framework enacted in the year 1904 did not contemplate the establishment of federal or central co-operatives to function as financing agencies for the primary co-operatives. However, the need for the institution of such second-tier co-operatives, with co-operatives as its members was felt. Accordingly, the enactment of the Co-operative Societies Act, 1912 was made which permitted the establishment of higher federal or central co-operatives.

Thereafter, the primary co-operative credit societies functioning in specified areas federated themselves into collective banking activities, giving birth to central co-operative banks with the prime objective to mobilize funds from urban outlets and divert the same to the rural societies. Gradually, over a period of time, every district in a state started having one or more cooperative bank. This reorganized them at district level to form District Central Co-operative Banks (DCCBs).

Functions

i) To act as a balancing centre of finance for the primary societies in the district by providing them funds when they have a shortage.

ii) To attract local deposits.

iii) To provide a safe place for investing the reserves of primary societies.

iv) To develop and extend banking facilities in rural areas.

v) To develop the co-operative movement in the district.

vi) To supervise, guide and control the working of member societies.

vii) To make PACS viable units for extending rural credit.

Q10. Explain the classification of DCCB Bank.

Ans : **(Imp.)**

The DCCB's in India can be classified under the following categories,

(a) Banks with Individual Membership

These banks comprises of individual members and in case any society is admitted as a member, it would enjoy the fights and privileges of an individual member only. These categories of banks are rare nowadays.

(b) Banks with Society Membership

The banks falling under this category are pure federal type of central banks. They do not admit individual members. They consider societies as their members. These banks are registered under the "Banking union act of 1912".

(c) Banks with Mixed Membership

These banks comprises of individual members and society members under this category of banks society members enjoy special representation and privileges. In India, major types of the banks reflect this pattern.

Size and Area

The Maclagan Committee (1915) had stated that "a central bank should cover as large an area as compatible with convenience and efficiency". Further, the standing advisory committee on agricultural credit of the Reserve Bank of India advocated that there is a need to have one central bank in each district. However, if the need arises, there can be more than one central bank established in district, as per the population and demand banking.

The standing advisory committee on agricultural credit of the Reserve Bank of India laid down the following guidelines for the establishment of one or more central bank in any district.

Following are some requirement related to such banks,

(a) The banks ability to generate reasonable profits.

(b) The banks ability to contribute sufficiently towards reserves.

Q11. Explain the various sources of funds used for financing DCCB Banks in India.

Ans :

The DCC Banks derive their working capital from the following sources,

(a) Share Capital

It is the most common source of financial funds for the DCC Banks wherein the DCC bank issues shares to its individual members and society members. Generally majority of the shares are issued to society members and the value of each share may range between ` 50 upto ` 100.

It is mandatory for the DCC bank to maintain sufficient paid up capital. In a recent survey conducted by the all India rural credit survey committee it has been observed that the respective state government are providing substantial amount of the paid up capital for the DCC banks.

(b) Public Deposits

Another important source of funds for the DCC banks are the public deposits that it could gather from the bank customers in the form of bank savings. Therefor the larger the amount of public deposits, the greater would be the finances of the DCC Bank.

(d) Reserve Funds

By law, the DCC banks are required to maintain different kinds of reserves, which may be utilized for the purpose of financing the banks rural customers. Generally, the DCC bank would maintain three kind of reserves statutory reserve, bad debt reserves and other reserves. Apart from these reserves, the DCC banks may maintain other reserves such as dividend reserve, building fund reserve, sinking fund reserve, investment depreciation reserve etc.

(e) Government Grants

Financial grants and assistance from the central government and the state government also form an important part of the source of fund for the DCC banks the government of India may provide financial grants under the various welfare programs to the DCC banks with the aim of providing financial credit and assistance to the rural customers across the country.

Q12. Explain the limitations of DCCB Banks.

Ans :

Following are the limitations of DCCB Bank.

1. Weak Capital Structure

Another weakness of DCC banks is that most DCC banks had been found to suffer from extremely weak capital structure. For example, a research survey found that the working capital of many DCC banks with less than ` 25 lakhs.

2. Poor Reserves

Another weakness of DCC banks is no or very poor maintenance of different types of statutory and optional reserves. Poor maintenance of financial reserves would make the bank financially weak and it would loose the trust of depositors and other stakeholders.

3. Maintenance for Bad Debts

In case of most DCC banks it has been found that provisions made for bad debts are inadequate and the book additions to the reserves was found to be defective.

4. Wrongful Profits

Many DCC banks were found to have transferred substantial portion of the funds and shown as profits. Thus, these banks displaying a wrong picture of the banks rather than actual financial position.'

2.4 Regional Rural Banks (RRB)

Q13. What are Regional Rural Banks.

Ans :

Regional Rural Banks are government owned scheduled commercial banks of India that operate at regional level in different states of India. These banks are under the ownership of Ministry of Finance, Government of India. They were created to serve rural areas with basic banking and financial services.

The RBBs Act has made various provisions regarding the incorporation, regulation and working of RRBs. According to this Act, the RRBs are to be set-up mainly with a view to develop rural economy by providing credit facilities for the purpose of development of agriculture, trade, commerce, industry and other productive activities in the rural areas.

Such facility is provided particularly to the small and marginal farmers, agricultural laborer's, artisans, and small entrepreneurs and for other related matters.

The Government of India appointed the Narasimham Committee in July 1975 to set up the new institutions in order:

- To provide employment to the rural educated youth; and
- To bring down the cost of rural banks by recruiting their staff on the same scale of pay and allowances as for the employees of State Government/Local bodies.

Initially, five RRBs were set up on October 2,1975 at

(i) Moradabad and Gorkhpur in Utter Pradesh sponsored by Syndicate Bank and SBI respectively.

(ii) Bhiwani in Haryana sponsored by PNB.

(iii) Jaipur in Rajasthan sponsored by United Commercial Bank; and

(iv) Malda in West Bengal sponsored by United Bank of India.

Each RBB has an authorised capital of ` 1 crore, and issued and paid-up capital of ` 25 lakhs.

The share capital of the RRB is subscribed by the Central Government (50%), the Stat; Government concerned (15%), and the sponsoring commercial bank (35%).

Q14. What are the objectives of RRB's.

Ans :

The objective of regional rural banks is to develop the rural economy by providing credit and other facilities for agriculture and other productive activities in rural areas. They provide these facilities to small and marginal farmers, rural artisans, agricultural laborer's and other small entrepreneurs working in the rural areas.

The objectives of RRBs can be summarized as follows:

- To provide loan for backward class public
- To opening branches of bank in rural areas.
- To save the rural poor from the moneylenders.
- To cultivate the banking habits among the rural people and mobilize savings for the economic development of rural areas.
- To increase employment opportunities by encouraging trade and commerce in rural areas.
- To encourage entrepreneurship in rural areas.
- To cater to the needs of the backward areas which are not covered by the other efforts of the Government?
- To develop underdeveloped regions and thereby strive to remove economic dispar-ity between regions.
- To increase employment opportunities by encouraging trade and commerce in rural areas.

Q15. What are the features of RRB's.

Ans :

The Features of RRBs can be summarized as follows:

- The area of operation of a rural bank is limited to a specified region which comprises of one or more districts.
- These banks cannot have a lending rate which is higher than the prevailing lending rate of cooperative credit societies in any particular state.
- The salary structure of the employees of these banks is fixed in consonance with the salary structure of the employees of the state government, local authorities of comparable level and status in the area.
- They are public sector banks. The paid-up capital of each bank is Rs. 25 lakhs. 50 percent of the capital is contributed by the Central Government. The concerned state

government contributes 15 percent. 35 percent is contributed by the sponsoring public-sector commercial banks.

- It grants loans and advance only to the small and marginal farmers, agricultural laborer's, small traders\ entrepreneurs.
- This is sponsored bank. It is sponsored by a scheduled commercial bank.
- The RRB charges interest rates as adopted by the co-operative society in the state.

Q16. What are the functions of RRB's.

Ans :

The functions of RRB can be summarized as follows:

- Providing of loans and advance to the farmers and other person already engaged in agriculture activities.
- Providing of loans and advance to the co-operative societies and other society which are involved in agriculture processing .
- Accepting the various types of deposits from the rural and other connected areas.
- providing loans and advances to small entrepreneurs and others who are engaged in trade, commerce and industry.
- Setting up and Maintenance of godowns and warehouse.
- Reducing the dependency of weaker section of money lenders.
- Undertaking of the supply of agricultural inputs & equipment's to farmers.
- Making backward and tribal areas economically better by opening new branches and extending micro credit facilities and operating the scheme of inclusion.

Q17. Explain the problems faced by RRB's.

Ans : **(Imp.)**

The followings are the serious problems faced by the RRBs :

1. **Haphazard branch expansion:** A large network of branches has been opened at a fast pace which has not contributed to substantial increase in business. It has added to overhead costs without contributing to profits. Moreover, major variations persist among States in the coverage of districts/ branches by the RRBs. In some states, backward areas still remain uncovered by these banks. In many districts, the RRBs do not have link branches at the Taluka/Block headquarters for meeting the cash requirements and to overcome other operational problems. In some of the places where branches are essential, it is difficult to get suitable accomodation for housing the branches.

2. **Defective recruitment policy:** The RRBs are expected to recruit staff locally being rural oriented. The candidates of the outside the areas of operations of RRBs are also made eligible for recruitment into RBBs with the transfer of recruitments of RRBs to the Banking Service Recruitment Boards. This is against the concept of RRBs where the 'local feel and familiarity' of the staff is essential for the successful working of the RRBs.

3. **Rigid norms:** The norms laid down for the selection of beneficiaries in RRBs are rigid and based on an all India income level. The poverty line available in Punjab is not the poverty line obtained in Andhra Pradesh. The village, its people, their occupations and economic status differ widely in one state with that of All India average. But to apply the same norms to all the States leave out many persons who are in need of credit from the RRBs.

4. **Weak capital base:** The capital base of each RRB is weak. Initially, the issue capital was ` 50 lakh which has been increased to ` 75 lakh and ` 1 crore in the case of selected RRBs. But the State Governments fail to contribute their share. This limit is on the lower side in view of its enormous credit obligation in rural areas. The working of many RRBs reveals that they are lacking their capital base on account of continuous losses.

5. **Constraints in deposits mobilisation:** RRBs have not been able to mobilise sufficient deposits as these banks supply credit only to the weaker sections of the rural population.

The weaker sections are poor and do not save money to deposit in the RRBs. The middle classes and the rural elite are not interested to deposit their saving in the RRBs. They deposit them in commercial banks from whom they get credit facilities.

6. **Erosion of profitability:** The RRBs have not been able to operate on a viable basis. The major factors which have contributed to the erosion of their profitability have been their lending exclusively to the weaker sections, low interest margins and high operating cost involved in handling small loans.

7. **Poor Recoveries:** The recovery of loans due has been very poor. The estimate of the Khusro Committee revealed that the recovery of RRBs was 49%. The main factors have been wilful defaults, misuse of loans, lack of follow-up, wrong identification of borrowers, extension of benami loans, staff agitations, etc.

Q18. Explain the various suggestions to improve the working of RRB's.

Ans : **(Imp.)**

1. **Merger of RRBs:** The Khusro Committee recommended that the RRBs should be merged with the commercial banks to improve the viability of RRBs. The merger would solve the problems of accumulated losses, of insolvency, and of the in-built non-viability of the majority of RRBs. But it is wrong to presume that after merger with sponsor banks, the RRBs will be viable because many branches of commercial banks are incurring huge losses. Therefore, the suggestions made by the Kelkar Committee should be implemented. They are the bifurcation of unwieldy RRBs, and the amalgamation of small RRBs.

2. **Strengthen the capital structure:** The Kelkar Committee recommended the raising of issued capital of RRBs from ` 25 lakhs to ` 1 crore and the authorised capital from ` 1 crores to ` 5 crore in order to strengthen the capital structure of RRBs.

3. **Keep the Government funds with RRBs:** The State Governments should permit the Panchayats and other quasi-government bodies functioning in rural areas to keep their funds with the RRB branches functioning within their area of operations as the verypurpose of establishing RRBs is to transfer funds from urban money market to rural centres.

4. **Reorganised agricultural Credit Societies:** The State Government should either reorganise agricultural credit societies or establish new Farmers' Service Soceities through which RRBs can provide production credit on a large scale and thereby the cost of servicing will be reduced considerably.

7. **Investment in Government Securities:** The sponsor banks should invest the deposits of RRBs in long-term Government securities which are being kept in non-interest earning current accounts.

8. **Extended credit facilities:** The RRBs should extend credit facilities to non-target groups subject to a ceiling of 25 percent of their total outstanding advances to increase the profit margin. The State Government should help the RRBs in recovering dues by creating a proper climate for recovery and in taking action against willful defaulters.

11. **Banking Education and Awareness:** The RRBs should devise suitable strategies to develop banking habits and practices among the rural folk by providing banking education and awareness.

12. **Wide Scope of Activities:** The RRBs should widen their scope of activities. They should provide rural consultancy services, phased credit programmes, create better avenues for employment, and take over the work of farmers' service societies instead of concentrating mainly on lending.

13. **Adjusted working hours:** As RRB is an area specific and target specific bank, its working hours should be suitably amended to enable the customers to make full use of its facilities. It is in consistent to have the usual office hours between to 10 AM to 5 PM in a village where the customers are busy in the fields at that time. Therefore, the working hours of RRBs should be fixed according to the needs of the area.

2.5 National Bank for Agriculture and Rural Development (NABARD)

Q19. Define NABARD. Explain the functions of NABARD.

Ans : **(Aug.-21, Imp.)**

Meaning

National Bank for Agriculture and Rural Development (NABARD) is an apex development bank in India, having head quarters in Mumbai and other branches are all over the country. The committee to review arrangements for institutional credit for agriculture and rural development setup by RBI, Conceived and recommended the establishment of National Bank for Agriculture and Rural Development.

NABARD was established on July 12,1982 by a special Act of Parliament. Its main focus was on upliftment of rural India by increasing the credit flow or elevation of agriculture and rural non-farm sector. It has been entrusted with matters concerning policy, planning and operations in the field of credit for agriculture and other economic activities in rural areas in India.

Capital

The authorized capital of NABARD is Rs. 500 crore. It can float bonds and debentures, can receive deposits from Central Government, commercial banks and local bodies. It can also borrow from foreign governments. The paid-up capital is contributed by the Central Government and the RBI in equal proportions. At the time of its establishment, loans and advances issued by the RBI and outstanding against State cooperative banks and Regional rural banks were transferred to NABARD. Besides, the RBI has also sanctioned a credit of Rs. 1200 crore to NABARD. For liberal financing NABARD receives funds from the World Bank and IDA.

Functions

a) It functions as an apex institution i.e., it takes up all the functions performed by the RBI with regard to rural credit. It attends to all the matters concerning policy, planning and operations in the field of credit for agriculture and other economic activities in rural areas.

b) It serves as refinancing agency for the institutions providing production and investment credit of promoting various developmental activities in rural areas.

c) It gives medium-term credit to State cooperative banks for seasonal agricultural operations, marketing of crops, distribution of fertilizers and working capital requirements of cooperative sugar mills.

d) It provides short-term credit to State cooperative banks for seasonal agricultural operations, marketing of crops, distribution of fertilizers and working capital requirements of cooperative sugar mills.

e) It extends medium-term and long-term credit of investment schemes in agriculture of State cooperative banks, Land development banks, Regional Rural Banks and commercial banks.

f) It provides long-term loans to State Government to for subscribing to the share capital of cooperative institutions.

g) It undertakes monitoring and evaluation of projects refinanced by it.

h) It takes measures towards institution building for improving absorptive capacity of credit delivery system. These measures include monitoring, formulation of rehabilitation schemes, reconstruction of credit institutions and training of personnel etc.

Q20. Explain the objectives of NABARD.

Ans :

The main objects of NABARD are as follows:

1. NABARD provides refinance assistance for agriculture, promoting rural development activities. It also provides all necessary finance and assistance to small scale industries.
2. NABARD in coordination with the State Governments, provides agriculture.
3. It improves small and minor irrigation by way of promoting agricultural activities.
4. It undertakes R&D in agriculture, rural industries.
5. NABARD promotes various organizations involved in agricultural production by contributing to their capital.

Q21. Discuss the achievements of NABARD.

Ans : **(Imp.)**

NABARD is a single integrated organization which looks after the credit requirements of all types of agricultural and rural development activities. Its performance in extending various types of financial assistance is as follows :

a) **Short-term Credit :** It provides short-term credit facilities to state cooperative Banks for financing seasonal agricultural operations, marketing of crops, pisciculture activities, purchase and distribution of fertilizers, marketing activities etc.

b) **Medium-term Credit :** Medium term facilities are provided to StCBs and RRBs for converting short-term loans into medium-term loans.

c) **Long-term Credit :** Long term loans are granted to State Governments.

d) **Assistance to Less Developed States :** It has continued the policy of promoting agricultural investment in the less developed and under-banked states.

e) **Assistance to Non-Farm Sector :** It also provides financial help to non-form activities with a view to promote integrated rural development. Finance I provided for production and marketing activities of cooperative sugar mills, recognized cottage and small scale industries.

f) **Rehabilitation Programme :** It has started taking active part in organizing and strengthening the cooperative credit structure of the country. It has initiated a rehabilitation programme for financially and administratively weak Central and State Cooperative banks.

g) **Assistance to Research and Development Projects :** Every year, it provides financial assistance to a number of banks from its Research and Development Fund for setting up or strengthening their Technical, Monitoring and Evaluation cell.

h) **Rural Infrastructure Development Fund:** The Union Budget 1995-96 proposed creation of Rural Infrastructure fund in NABARD with a corpus of Rs. 2000 crore.

i) **Kisan Credit Cards :** It was introduced in 1998-99. They are issued to farmers by commercial banks, cooperative and RRBs. These cards enable the farmers to obtain credit. The limit of Rs. 5,000 was dispensed with. The loans disbursed under KCC scheme are insured by the General Insurance Corporation.

2.6 Industrial Development Bank of India (IDBI)

Q22. Define IDBI. Explain the objectives of Industrial Development Bank of India (IDBI).

Ans : **(Imp.)**

Industrial Development Bank of India (IDBI) established under Industrial Development Bank of India Act, 1964, is the principal financial institution for providing credit and other facilities for developing industries and assisting development institutions.

Till 1976, IDBI was a subsidiary bank of RBI. In 1976 it was separated from RBI and the ownership was transferred to Government of India. IDBI is the tenth largest bank in the world in terms of development. The National Stock Exchange (NSE), the National Securities Depository Services Ltd. (NSDL), Stock Holding Corporation of India (SHCIL) are some of the Institutions which has been built by IDBI.

Organization and Management

IDBI consist of a Board of Directors, consisting of a chairman and Managing Director appointed by the Government of India, a Deputy Governor of the RBI nominated by that bank and 20 other Directors are nominated by the Central Government.

The board had constituted an Executive Committee consisting of 10 Directors, including the Chairman and Managing Director. The executive committee is empowered to sanction financial assistance.

The Head office of IDBI is located in Mumbai. The bank has five regional offices, one each in Kolkata, Guwahati, New Delhi, Chennai and Mumbai. Besides the bank have 21 branch offices.

Objectives

- The main objectives of IDBI is to serve as the apex institution for term finance for industry in India. Its objectives include:
- Co-ordination, regulation and supervision of the working of other financial institutions such as IFCI, ICICI, UTI, LIC, Commercial Banks and SFCs.
- Supplementing the resources of other financial institutions and there by widening the scope of their assistance.
- Planning, promotion and development of key industries and diversification of industrial growth.
- Devising and enforcing a system of industrial growth that conforms to national priorities.

Q23. What are the functions and assistance of IDBI?

Ans :

Functions

(i) To provide financial assistance to industrial enterprises.

(ii) To promote institutions engaged in industrial development.

(iii) To provide technical and administrative assistance for promotion management or expansion of industry.

(iv) To undertake market and investment research and surveys in connection with development of industry.

Assistance

The IDBI provides financial assistance either directly or through some specified financial institutions:

(i) Direct Assistance

The IDBI grants loans and advances to industrial concerns. There is no restriction on the upper or lower limits for assistance to any concern itself. The bank guarantees loans raised by industrial concerns in the open market from the State Co-operative Banks, the Scheduled Banks, the Industrial Finance Corporation of India (IFCI) and other 'notified' financial institutions.

(ii) Indirect Assistance

The IDBI can refinance term loans to industrial concerns repayable within 3 to 25 years given by the IFCI, the State Financial Corporation and some other financial institutions and to SIDCs (State Industrial Development Corporations), Commercial banks and Cooperative banks which extend term loans not exceeding 10 years to industrial concerns. IDBI subscribes to the shares and bonds of the financial institutions and thereby provide supplementary resources.

Q24. What are the developmental activities of IDBI?

Ans :

1. Promotional Activities

In fulfillment of its developmental role, the bank continues to perform a wide range of promotional activities relating to developmental programmes for new entrepreneurs, consultancy services for small and medium enterprises and programmes designed for accredited voluntary agencies for the economic upliftment of the underprivileged.

These include entrepreneurship development, self-employment and wage employment in the industrial sector for the weaker sections of society through voluntary agencies, support to Science and Technology Entrepreneurs' Parks, Energy Conservation, Common Quality Testing Centers for small industries.

2. Technical Consultancy Organizations

With a view to making available at a reasonable cost, consultancy and advisory services to entrepreneurs, particularly to new and small entrepreneurs, IDBI, in collaboration with other All-India Financial Institutions, has set up a network of Technical Consultancy Organizations (TCOs) covering the entire country. TCOs offer diversified services to small and medium enterprises in the selection, formulation and appraisal of projects, their implementation and review.

3. Entrepreneurship Development Institute

Realising that entrepreneurship development is the key to industrial development; IDBI played a prime role in setting up of the Entrepreneurship Development Institute of India for fostering entrepreneurship in the country. It has also established similar institutes in Bihar, Orissa, Madhya Pradesh and Uttar Pradesh. IDBI also extends financial support to various organisations in conducting studies or surveys of relevance to industrial development.

Q25. Explain the importance of IDBI.

Ans :

1. Planning, promoting and developing industries with a view to fill the gaps in the industrial structure by conceiving, preparing and floating new projects.
2. Providing technical and administrative assistance for promotion, management and expansion of industry.
3. Providing refinancing facilities to the IFCI, SFCs and other financial institutions approved by the government.
4. Co-ordinating the activities of financial institutions for the promotion and development of industries.
5. Purchasing or underwriting shares and debentures of industrial units.
6. Guaranteeing deferred payments due from industrial units and for loans raised by them.
7. Undertaking market and investment research surveys and techno-economic studies helpful to the development of industries.
8. To provide refinance to scheduled banks or co-operative banks.
9. To provide refinance to financial institutions granting medium and long-term loans to industry.

2.7 Small Industries Development Bank of India (SIDBI)

Q26. What is SIDBI? Discuss the objectives and functions of SIDBI ?

Ans : **(Imp.)**

Small Industries Development Bank of India (SIDBI) was established as wholly owned subsidiary of Industrial Development Bank of India (IDBI) under the Small Industries Development of India Act, 1989. It is the principal institution for promotion, financing and development of industries in the small scale sector. It also coordinates the function of institutions engaged in similar activities.

Objectives

a) Initiating steps for technological upgradation and modernization of existing units
b) Expanding the channels for marketing the products of the small scale sector
c) Promotion of employment-oriented industries, especially in semi urban areas to create more employment opportunities and thereby checking migration of population to urban areas.

Functions

a) It refinances loans and advances provided by the existing lending institutions to the small scale units.
b) It discounts and rediscounts bills arising from sale of machinery to and manufactured by small scale industrial units.
c) It extends financial support to State Small Industries Corporation for providing scarce raw materials to and marketing to and marketing the products of the small scale units.

d) It provides services like factoring, leasing etc to small units.

e) It extends financial support to State Small Industries Corporations for providing scarce raw materials to and marketing the products of the small scale units.

f) It provides financial support to National Small Industries Corporation for providing, leasing, hire-purchase and marketing help to the small scale units

Capital of SIDBI

SIDBI started its operations from April 1990 with an initial authorized capital of Rs. 250 crore, which could be increased to Rs. 1000 crore. It also took over the outstanding portfolio of IDBI relating to small scale sector held under Small Industries Development Fund as on March 31, 1990 worth over Rs. 4000 crores.

2.8 Development Banks

Q27. What are Development Banks? Explain various definitions of Development Banks.

Ans :

Meaning

The concept of development bank is of recent origin in the field of industrial finance. The emergence of bank (DFIs) is a post-independent phenomenon in India. These are the specialized banks which provide all types of medium and long-term financial assistance to business units.

Development bank had a long period of evolution in the Western countries. The origin of development bank may be traced to the establishment of 'Societa Generale Pour Favoriser Industrie Nationale' in Belgium in 1822. But the 'Credit Mobiliser' was the notable institution. The 'Credit Mobiliser' was established in 1852 which acted as industrial financier in France.

The Industrial Financial institution of Japan was established in 1920 to meet the financial need of industrial development of Japan. The Industrial Development Financial institution of Canada (1944), the Finance Corporation for Industry Ltd. (FCI) and the Industrial and Commercial Finance Corporation Ltd. (ICFC) of England (1945) were established as modern development banks to provide term loans to industry after the World War II. The U.K. Government has established the Industrial Reorganisation Corporation (IRC) in 1966.

Definitions

The followings are the important definitions of a development bank :

(i) According to William Diamond "A development bank have the opportunity to promote enterprises i.e. to conceive investment proposals and to stimulate others to pursue them or itself to carry them through, from 'conception' to 'realisation'."

(ii) According to A.G. Kheradjou "A development bank is like a living organism that reacts to the socio-economic environment and its success depends on reacting most aptly to that environment." -

(iii) According to D.M. Mithani "A development bank may be defined as a bank concerned with providing all types of financial assistance (medium as well as long-term) to business units in the form of loans, underwriting, investment and guarantee operations, and promotional activities-economic development in general, and industrial development, in particular."

Therefore, a development bank is a term-lending institution which provide medium and long-term finance for industrial growth and development of a country. A development bank is a bank which takes up the job of development of industrial enterprises from its conception to completion. The development bank provide sufficient financial resources and expert services to promote a new industrial unit. In this view a development bank provides financial and promotional facilities for the overall development of a country.

Q28. What are the functions of Development Banks?

Ans : **(Imp.)**

Now let's discuss each important function of development banks one by one.

1. **Small Scale Industries (SSI):** Develop ment banks play an important role in the promotion and development of the small-scale sector.

Government of India (GOI) started Small industries Development Bank of India (SIDBI) to provide medium and long-term loans to Small Scale Industries (SSI) units. SIDBI provides direct project finance, and equipment finance to SSI units. It also refinances banks and financial institutions that provide seed capital, equipment finance, etc., to SSI units.

2. Development of Housing Sector

Development banks provide finance for the development of the housing sector. GOI started the National Housing Bank (NHB) in 1988.

NHB promotes the housing sector in the following ways:

1. It promotes and develops housing and financial institutions.
2. It refinances banks and financial institutions that provide credit to the housing sector.

3. Large Scale Industries (LSI)

Development banks promote and develop large-scale industries (LSI). Development financial institutions like IDBI, IFCI, etc., provide medium and long-term finance to the corporate sector. They provide merchant banking services, such as preparing project reports, doing feasibility studies, advising on location of a project, and so on.

4. Agriculture and Rural Development

Development banks like National Bank for Agriculture & Rural Development (NABARD) helps in the development of agriculture. NABARD started in 1982 to provide refinance to banks, which provide credit to the agriculture sector and also for rural development activities. It coordinates the working of all financial institutions that provide credit to agriculture and rural development. It also provides training to agricultural banks and helps to conduct agricultural research.

5. Enhance Foreign Trade

Development banks help to promote foreign trade. Government of India started Export-Import Bank of India (EXIM Bank) in 1982 to provide medium and long-term loans to exporters and importers from India. It provides Overseas Buyers Credit to buy Indian capital goods. It also encourages abroad banks to provide finance to the buyers in their country to buy capital goods from India.

6. Review of Sick Units

Development banks help to revive (cure) sick-units. Government of India (GOI) started Industrial investment Bank of India (IIBI) to help sick units.

IIBI is the main credit and reconstruction institution for revival of sick units. It facilitates modernization, restructuring and diversification of sick-units by providing credit and other services.

7. Entrepreneurship Development

Many development banks facilitate entrepreneurship development. NABARD. State Industrial Development Banks and State Finance Corporations provide training to entrepreneurs in developing leadership and business management skills. They conduct seminars and workshops for the benefit of entrepreneurs.

8. Regional Development

Development banks facilitate rural and regional development. They provide finance for starting companies in backward areas. They also help the companies in project management in such less- developed areas.

9. Contribution to Capital Markets

Development banks contribute the growth of capital markets. They invest in equity shares and debentures of various companies listed in India. They also invest in mutual funds and facilitate the growth of capital markets in India.

Q29. What are the objectives of Development Banks?

Ans :

i) Development banks speed up the growth and development of economy by establishing new industrial units.

ii) Development banks helps in the development of different sectors of the economy like industry, agriculture and international trade etc.

iii) Development banks extend finance to the projects having important place in economic development.

iv) Development banks are providing the technical and administrative assistance to small and new entrepreneurs for increasing the pace of industrialisation.

v) These institutions undertake the marketing and investment research and conduct surveys for the promotion of industrial enterprises.

vi) Development banks also provide financial assistance for the export promotion activities of the country.

vii) Development banks extend economic help to banking and small scale industries in the developing countries like India.

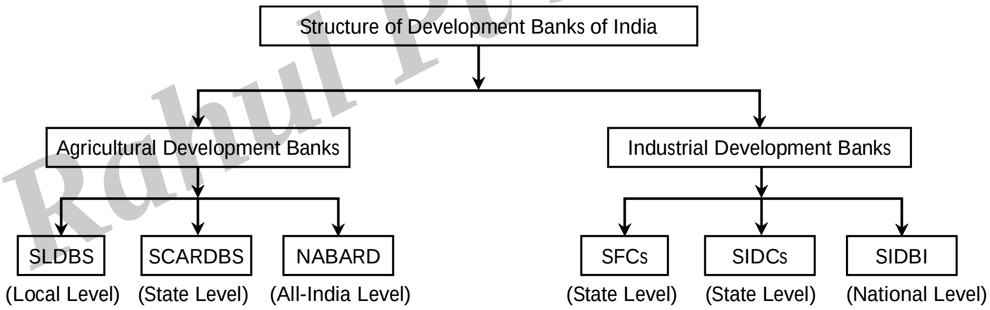
viii) Development banks also work for rural development of the economy.

xi) Development banks are also helpful in developing entrepreneurial skill and abilities by providing training facilities specially in industrial sector.'

Q30. Explain various types of development banks.

Ans :

The various types of development banks are discussed as below,



i) SLDBS – State Land Development Banks

ii) SCARDBS – State Co-operative Agricultural and Rural Development Banks

iii) NABARD – National Bank for Agriculture An Rural Development

i) SFCs – State Finance Corporation

ii) SIDCs – State Industrial Development Corporations

iii) SIDBI – Small Industrial Development Banks of India

Fig.: Types of Development Banks

I) Agricultural Development Banks

Following are the Agricultural Development Banks,

i) SLDBs: SLDBs stands for State Land Dvelopment Banks. It is known as Primary Land Development Banks.

ii) SCARDBs: SCARDBs stands for State Co-operative Agriculture and Rural Development Banks. It is a national or central level scheme of India which aims to raise resource for long term lending to cultivators.

iii) NABARD: National Bank for Agriculture and Rural Development (NABARD) is introduced for promoting credit facilities to agriculture, small scale industries, cotton and village industries, handicrafts and other rural craft industries, NABARD came into existence after passing a bill in the parliament in July 12, 1982.

With the establishment of NABARD on July 12,1982, the department of RBI engaged in providing the agricultural finance, agricultural refinance and development corporation were controlled and managed by NABARD. As it is undertaking the agricultural related activities of RBI, the assets and liabilities of the agricultural credit funds were transferred to NABARD.

II) Industrial Development Banks

Following are the Industrial Development Banks,

i) SFCs: The state financial corporation of India was setup in order to provide financial assistance only to small and medium sized industries. It was initiated through the SFC Act which was passed by the parliament on September 28, 1951. The first financial corporation was setup in 1953 in Punjab. At present, there are about 18 SFCs which are operating since 40 years and they function as regional development bank.

ii) SI DCs: State Industrial Development Corporations (SIDC) was setup under the Company's Act, 1956, in the 1960 and 1970 as a wholly owned undertaking of state government with an objective of promoting and developing medium and large industries. They play a predominant role in industrial development.

iii) SIDBI: Small Industries Development Bank of India (SIDBI) was started by Government of India (GOI) under the Parliament's Act in October 1989 as a wholly owned IDBI subsidiary. It was basically set up as an apex institution for providing financial and non-financial assistance to tiny and small scale industries.

Other Types of Development Banks

It includes the following banks,

1. **Industrial Finance Corporation of India (IFCI):** IFCI was setup by the government of India under IFCI Act in July 1948. Since July 1,1993 it has been included under the Companies Act, 1956. The IFCI provides financial assistance to the industrial sector in the form of rupee and foreign currency loans, underwriting, subscription to shares and debentures and purchase of equipment procurement, leasing, merchant banking facilities, etc.

2. **Industrial Credit and Investment Corporation of India (ICICI):** ICICI was set up in January 1955 and it commenced business in March 1955. ICICI differs from IDBI and IFCI in respect of ownership, management and lending. It ceased to be a development finance institution on account of its merger into ICICI bank in April 2002.

3. **Industrial Development Bank of India (IDBI):** The IDBI was established on 1st July 1964. It was setup in order to provide institutional finance to the upcoming large and small scale industries. IDBI came into existence under the parliament act as a completely owned subsidiary of the Reserve Bank of India. It provides finance to the new business in key areas and also provides assistance to the projects in public and private sector.

4. **Industrial Reconstruction Bank of India (IRBI):** IRCI (Industrial Reconstruction Corporation of India) was established by the Government of India (GOI) in April 1971 under the Indian Companies Act, 1956.

The aim and objective of IRCI was to solve the problems and difficulties faced by the sick units and give proper and quick assistance for speedy reconstruction and development of those industries. GOI passed an act and converted IRCI into IRBI in August, 1984. The function of IRBI is to serve as an apex institution in expansion, revival, promotion and development of industrial units.

In the year 1995, IRBI was given the status of a full fledged financial institute engaged in the development of a country. Later it was renamed as the Industrial Investment Bank of India (IIBI).

5. Export Import Bank of India (EXIM)

The EXIM was established in the year 1982 on 1st January under the Act of parliament as the principal financial institution for promoting and financing international trade of India. The EXIM bank provides financial assistance to both exporters and importers for production and sale of goods and services.

Besides the above assistance, the EXIM bank promotes exports by advising and providing informative services on merchant banking country risk analysis, procedures of multilateral institutions etc., to the exporters.

6. Life Insurance Corporation of India (LIC)

The LIC of India was setup under the LIC Act, 1956, as the wholly-owned corporation of India. After the nationalisation of the life insurance business it was taken over by the government from the private players. The primary objective of LIC is to do business and mobilise the funds to provide social security to the individuals, rurals and urban group etc.

7. Unit Trust of India (UTI)

The UTI was created by an Act of parliament in the year 1964. The UTI mobilizes the savings of small investors and channelises them into business/ corporate investments. The UTI provides assistance by granting term loans, underwriting and subscription of shares and debentures.

Q31. Discuss briefly about IFCI.

Ans :

Government of India came forward to set up the Industrial Finance Corporation of India (IFCI) in July 1948 under a Special Act. The Industrial Development Bank of India, scheduled banks, insurance companies, investment trusts and co-operative banks are the shareholders of IFCI. The Government of India has guaranteed the repayment of capital and the payment of a minimum annual dividend.

Since July I, 1993, the corporation has been converted into a company and it has been given the status of a Ltd. Company with the name Industrial Finance Corporations of India Ltd. IFCI has got itself registered with Companies Act, 1956. Before July I, 1993, general public was not permitted to hold shares of IFCI, only Government of India, RBI, Scheduled Banks, Insurance Companies and Co-operative Societies were holding the shares of IFCI.

Management of IFCI

The corporation has 13 members Board of Directors, including Chairman. The Chairman is appointed by Government of India after consulting Industrial Development Bank of India. He works on a whole time basis and has tenure of 3 years. Out of the 12 directors, four are nominated by the IDBI, two by scheduled banks, two by co-operative banks and two by other financial institutions like insurance companies, investment trusts, etc.

IDBI normally nominates three outside persons as directors who are experts in the fields of industry, labour and economics, the fourth nominee is the Central Manager of IDBI. The Board meets once in a month. It frames policies by keeping in view the interests of industry, commerce and general public.

The Board acts as per the instructions received from the government and IDBI. The Central Government reserves the power up to the Board and appoints a new one in its place.

Financial Resources of IFCI

The financial resources of the corporation consist of share capital bonds and debentures and borrowings.

a) **Share Capital:** The IFCI was set up with an authorized capital of Rs. 10 crores consisting of 20,000 shares of Rs. 5,000 each. This capital was later on increased at different times and by March, 2003 it was Rs. 1068 crores. The capital was subscribed by Central Government, Reserve Bank of India, scheduled banks, Life Insurance Corporation, investment trusts, co-operative banks are other financial institutions.

In 1964, the share capital held by the central government and RBI was transferred to the Industrial Development Bank. The corporation thus became a subsidiary of IDBI. The central government had guaranteed the shares of the corporation both for repayment of the principal and for the payment of a dividend at 2.5 per cent on the original issue and 4 per cent on the additional issues. However, since July , 1993 IFCI has been converted into a limited company.

b) **Bonds and Debentures :** The corporation is authorized to issue bonds and debentures to supplement its resources but these should not exceed ten times of paid-up capital and reserve fund. The bonds and debentures stood at a figure of Rs. 57.69 crores 1971 and rose to Rs. 15366.5 crores as on 31st March 2003. The bonds and debentures are also guaranteed by the central government for both payment of interest at such rates as may be fixed at the time the bonds and debentures are issued.

c) **Borrowings** : The corporation is authorized to borrow from government IDBI and financial institutions. Its borrowings from IDBI and Govt. of India were Rs. 975.6 crore on March 31, 2003. Total assets of IFCI as on March 31, 2003 aggregated Rs. 22866 crore including investments of Rs. 3820.3 crore and loans and advances of Rs. 13212.8 crore.

Q32. Explain the functions of IFCI.

Ans :

IFCI is authorized to render financial assistance in one or more of the following forms :

1. Granting loans or advances to or subscribing to debentures of industrial concerns repayable within 25 years. Also it can convert part of such loans or debentures into equity share capital at its option.
2. Underwriting the issue of industrial securities i.e. shares, stock, bonds, or debentures to be disposed off within 7 years.
3. Subscribing directly to the shares and debentures of public limited companies.
4. Guaranteeing of deferred payments for the purchase of capital goods from abroad or within India.
5. Guaranteeing of loans raised by industrial concerns from scheduled banks or state co-operative banks.
6. Acting as an agent of the Central Government or the World Bank in respect of loans sanctioned to the industrial concerns.

Q33. Discuss the promotional activities of IFCI.

Ans :

The IFCI has been playing very important role as a financial institution in providing financial assistance to eligible industrial concerns. However, no less important to its promotional role whereby it has been creating industrial opportunities also. It has been taking up directly as well as indirectly; such steps and activities are regarded necessary for the acceleration of the process of industrialization in the country.

The promotional role of IFCI has been to fill the gaps, either in the institutional infrastructure for the promotion and growth of industries, or in the provision of the much needed guidance in project intensification, formulation, implementation and operation, etc. to the new tiny, small-scale or medium scale entrepreneurs or in the efforts at improving the productivity of human and material resources.

1. Development of Backward Areas

The main thrust of all financial institutions has been to removal of regional imbalances by promoting industrialization of backward areas. IFCI introduce a scheme of confessional finance for projects set up in backward areas. The backward-districts were divided into three categories depending upon the state of development there. All these categories were eligible for concessional finance. Nearly 50 per cent of total lending of IFCI has been to develop backward areas.

2. Promotional Schemes

IFCI has been operating six promotional schemes with the object of helping entrepreneurs to set up new units, broadening the entrepreneurial base, encouraging the adoption of new technology, tackling 'the problem of sickness and promoting opportunities for self development and self employment of unemployed persons etc. These schemes are as such:

a) **Subsidy for Adopting Indigenous Technology :** The projects which use indigenously developed technology are entitled to a concession in the form of subsidy covering interest payments due to IFCI during the first three years of operations, extendable to five years.

b) **Meeting Cost of Market Studies :** The entrepreneurs setting up medium sized industrial projects for the first time can avail 75 per cent of the cost of market survey/study subject to a ceiling of Rs. 15,000 provided it is handled by Technical Consultancy Organization. .

c) **Meeting Cost of Feasibility Studies:** IFCI provides subsidy for the fees paid for consultancy assignments relating to feasibility, project reports etc. The amount allowable is 80 per cent of the fees of Rs. 7,500 whichever is less. This limit is Rs. 8,500 or 100 per cent of the total fees whichever is less for handicapped or scheduled caste persons.

3. Promoting Small Scale and Ancillary Industries

For the identification of products suitable for ancillary or further processing in small scale sector and preparation of feasibility reports a subsidy of Rs. 0.1 million per annum for technical consultancy organization is allowed.

4. Revival of Sick Units

There is a subsidy to the extent of 80 per cent or Rs. 5,000 (whichever is less) for the fees charged by a technical consultancy organization for carrying out a diagnostic study or for the implementation of rehabilitation programme. This facility is allowed to tiny units or units in small scale sector.

5. Self-development and Self employment Scheme

An unemployed person in the age group of 21 to 35 years may be allowed a soft loan for providing margin money for getting a loan from a bank or a financial institution. The soft loan at interest free rate in first year and has confessional interest later on. The amount available under this scheme is 25% of margin money subject to Rs. 5000.

Financial institutions provide means and mechanism of transferring resources from those who have an excess of income over expenditure to those who can make productive use of the same. The commercial banks and investment institutions mobilize savings of people and channel them into productive uses.

Financial institutions provide all type of assistance required infrastructural facilities Institutions of economic persons who can take the development in the following ways.

a) **Providing Funds :** The under-developed countries have low levels of capital formation. Due to low incomes, people are not able to save sufficient funds which are needed for sensing up new units and also for expansion diversification and modernization of existing units. The persons who have the capability of starting a business but does not have requisite help approach to financial institutions for help.

These institutions help large number of persons for taking up some industrial activity. The addition of new industrial units and increasing the activities of existing units will certainly help in accelerating the pace of economic development. Financial institutions have large invertible funds which are used for productive purposes.

b) **Infrastructural Facilities :** Economic development of a country is linked to the availability of infrastructural facilities. There is a need for roads, water, sewage, communication facilities, electricity etc. Financial institutions prepare their investment policies by keeping national priorities in major and the institutions invest in those aim is which can help in increasing the development of the country.

c) **Promotional Activities :** An entrepreneur faces many problems while setting up a new unit. One has to undertake a feasibility report, prepare project report, complete registration formalities, seek approval from various agencies etc. All these things require time, money and energy. Some people are not able to undertake this exercise or some do not even take initiative. Financial institutions are the expense and manpower resources for undertaking the exercise of starting a new unit.

d) **Development of Backward Areas :** Some areas remain neglected because facilities needed for setting up new units are not available here. The entre-preneurs set up new units at those places which are already developed. It causes imbalance in economic development of some areas. In order to help the development of backward areas, financial institutions provide special assistance to entrepreneurs for setting up new units in these areas. IDBI, IFCI, ICICI give priority in giving assistance to units set up in backward areas and even charge lower interest rates on lending.

Such efforts certainly encourage entrepre-neurs to set up new units in backward areas. The industrial units in these areas improve basic amenities and create employment opportunities. These measures will certainly help in increasing the economic development of backward areas.

6. Planned Development

Financial institutions help in planned development of the economy. Different institutions earmark their spheres of activities so that every business activity is helped. Some institutions like SIDBI, SFCI's especially help small scale sector while IFCI and SIDC's finance large scale sector or extend loans above a certain limit.

7. Accelerating Industrialization

Economic development of a country is linked to the level of industrialization there. The setting up of more industrial units will generate direct and indirect employment, make available goods and services in the country and help in increasing the standard of living. Financial institutions provide requisite financial, managerial, technical help for setting up new units. In some areas private entrepreneurs do not want to risk their funds or gestation period His long but the industries are needed for the development of the area.

Financial institutions provide sufficient funds for their development. Since 1947, financial institutions have played a key role in accelerating the pace of industrialization. The country has progressed in almost all areas of economic development.

8. Employment Generation

Financial institutions have helped both direct and indirect employment generation. They have employed many persons to man their offices. Besides office staff, institutions need the services of experts which help them in finalizing lending proposals.

These institutions help in creating employment by financing new and existing industrial units. They also help in creating employment opportunities in backward areas by encouraging the setting up of units in those areas, Thus financial institutions have helped in creating new and better job opportunities.

Q34. Explain the Economic contribution of IFCI.

Ans :

The economic contribution of IFCI can be measured from the following points,

1. Since its establishment, IFCI has spent ` 444 billion and it has sanctioned financial assistance of ` 462 billion to 5,707 concerns.
2. It has made investments of ` 2,526 billion in the infrastructure and industrial sectors.
3. The assistance of IFCI helped in creating production capacities of,
   - 8 port project, 1 bridge project and 66 telecoms projects.
   - 5,544 hospital beds.
   - 22,106 hotel rooms.
   - 14,953 mw of electricity.
   - 30.2 million tpa of steel and iron.
   - 59.3 million tpa of cement.
   - 18.5 million tpa of fertilizers.
   - 1.7 million tonnes tpa of paper and paper related products.
   - 7.2 million tpa of sugar production.
   - 6.5 million spindles in the textile industry.
   - 32.8 million tpa of petroleum refining.

Q35. Explain the features of SFCs.

Ans :

The IFCI provides financial assistance to large public limited companies and cooperative societies and does not cover the small and medium-sized industries. In order to meet the varied financial needs of small and medium sized industries, the Government of India passed the State Finance Corporations Act in 1951 which empowers the State Governments to establish such Corporations in their states. The first State Finance Corporation was set up in Punjab in 1953.

Features of SFC's

a) The SFCs were set up with the objective of providing the financial assistance to the small as well as the medium industrial concerns. Though there has been a notable rise in the overall financial assistance, the performance in individual Corporations differed largely due to the attitudes and motivations of the local entrepreneurs in different states.

b) Prior to 1966, the SFCs showed preference for medium industries. But, now there has been a marked shift in their lending policies in favour of the small units.

c) Major beneficiaries of the financial assistance of the SFCs have been the food processing industries, services, chemicals, textiles, metal products, machinery.

d) A special feature of the lending operations of SFCs has been the provision of finance to industrial concern of backward areas.

e) The SFCs provide concessional assistance to the industrial units located in backward area in terms of soft loans at concessional rates, lower margins, reduced service charges etc.

f) In order to encourage self-employment, the SFCs have formulated schemes of assistance to technician-entrepreneurs.

Q36. List out the objectives of SFC's.

Ans :

Objectives of SFC's

1. Provide financial assistance to small and medium industrial concerns.
2. Provide long and medium-term loan repayable ordinarily within a period not exceeding 20 years.
3. Grant financial assistance to any single industrial concern under corporate or co-operative sector with an aggregate upper limit of rupees Sixty lakhs.
4. To lay special emphasis on the development of backward areas and small scale industries.

Q37. What are the functions of SFC's ?

Ans :

a) The SFCs have been established to provide long-term finance to small-scale and +medium-sized industrial concerns organized as public or private companies, corporations, partnerships.

b) The SFCs extend loans and advances to the industrial concerns repayable within a period of 20 years.

c) The SFCs guarantees loans raised by the industrial concerns in the market or from scheduled or cooperative banks and repayable within 20 years.

d) The SFCs subscribes to the debentures of the industrial concerns repayable within a period of 20 years.

e) The SFCs guarantee loans raised by the industrial concerns from scheduled or cooperative banks and repayable within 20 years.

f) The SFCs underwrite the issue of stocks, shares, bonds and debentures by industrial concerns.

g) The SFCs guarantee the deferred payments for the purchase of plant, machinery etc. within the country.

h) The SFCs are prohibited from subscribing directly to the shares or stock of any company having limited liability, except for underwriting purposes and granting any loan or advance on the security of own shares.

Q38. Explain the financial Resources of the SFCs.

Ans :

The capital resources of the SFCs includes :

a) Share capital and reserves

b) Bonds and debentures

c) Borrowing from the RBI, State governments

d) Finance from IDBI

e) Deposits

The SFCs can also raise funds by issuing bonds and debentures. Bonds and debentures issued by the Corporation are guaranteed by the respective State governments and mostly subscribed by the commercial banks and other financial institutions.

Q39. Explain the Prospects and drawbacks of SFC's

Ans :

Prospects

1. Special Help to Women Entrepreneurs

Many state financial corporation like Delhi SFC have state new scheme for helping women who want to open their new business in India. This is good prospect of state financial corporation for development of women.

2. Highest Loan Provider for Small Scale Industry

It is also achievement of SFCs that these institutions have provided more than Rs. 6,300 crore to small scale industry in 2010.

3. Industrial Research

Since establishing SFCI in 1951, SFCs are working 59 years in India. So, these financial institutions have huge industrial information and these institutions are also busy for collecting industrial information. A new businessman can start their industrial research by contacting these institutions if he wants to open a new business.

Drawbacks of SFC's

a) The financial resources for the SFCs are inadequate. They face the difficulty of finding funds.

b) The SFCs have not been able to provide adequate financial assistance to meet the requirements of small and medium industries.

c) The SFCs charge very high interest rates on all loans other than the soft loans.

d) The SFCs also face the serious problem of increasing magnitude of over dues. The main reasons for over dues are delay in the implementation of projects and industrial sickness.

e) The SFCs lack self-sufficient organizational set up along with adequate specialized and trained staff for ensuring their efficient functioning.

f) There is also a shortage of technical personnel for judging the soundness of the proposed schemes of the borrowing units.

g) Many difficulties are faced by the SFCs while extending financial assistance to the small industrial units.

Short Question and Answers

1. RBI.

Ans :

The RBI Act, 1934 is a primary legislation for regulating banking services in India. The Reserve Bank of India is given the authority to control all banks from their establishment till their windup. It is monopoly bank.

Establishment

Reserve Bank of India (RBI) is the central bank of India. It came in to reality after many difficulties. Imperial Bank of India founded in 1921 was considered as the leader of Indian banks. Any way RBI came in to reality by the passing of Reserve Bank of India Act in 1934 and started its functions from 1935.

At the beginning of the RBI, it was owned by private individuals with government. Finally in 1948 the central government become the whole owner of RBI.

Today, economic system should be favor, then only they can shine before other nations. So, it is very essential for a central bank to deal with the financial resources of the country. RBI is the one of the strongest central bank performing many functions.

2. Define Monetary Policy.

Ans :

Meaning

Monetary policy refers to the process by which the monetary authority of a country controls the supply of money, often targeting a rate of interest to attain a set of objectives oriented towards the growth and stability of the economy.

Definitions

Many economists have given various definitions of monetary policy. Some prominent definitions are as follows:

i) **According to Prof. Harry Johnson,** "Monetary policy is a policy employing the central banks control of the supply of money as an instrument for achieving the objectives of general economic policy is a monetary policy."

ii) **According to A.G Hart,** "Monetary policy is a policy which influences the public stock of money substitute of public demand for such assets of both that is policy which influences public liquidity position is known as a monetary policy."

3. Price level targeting

Ans :

Price level targeting is similar to inflation targeting except that CPI growth in one year over or under the long term price level target is offset in subsequent years such that a targeted price-level is reached over time, e.g. five years, giving more certainty about future price increases to consumers. Under inflation targeting what happened in the immediate past years is not taken into account or adjusted for in the current and future years.

4. Fixed exchange rate

Ans :

Monetary policy is based on maintaining a fixed exchange rate with a foreign currency. There are varying degrees of fixed exchange rates, which can be ranked in relation to how rigid the fixed exchange rate is with the anchor nation.

Under a system of fiat fixed rates, the local government or monetary authority declares a fixed exchange rate but does not actively buy or sell currency to maintain the rate. Instead, the rate is enforced by non-convertibility measures (e.g. capital controls, import/export licenses, etc.). In this case there is a black market exchange rate where the currency trades at its market/unofficial rate.

Under a system of fixed-convertibility, currency is bought and sold by the central bank or monetary authority on a daily basis to achieve the target exchange rate. This target rate may be a fixed level or a fixed band within which the exchange rate may fluctuate until the monetary authority intervenes to buy or sell as necessary to maintain the exchange rate within the band. Under a system of fixed exchange rates maintained by a currency board every unit of local currency must be backed by a unit of foreign currency (correcting for the exchange rate). This ensures that the local monetary base does not inflate without being backed by hard currency and eliminates any worries about a run on the local currency by those wishing to convert the local currency to the hard (anchor) currency.

5. Gold standard

Ans :

The gold standard is a system under which the price of the national currency is measured in units of gold bars and is kept constant by the government's promise to buy or sell gold at a fixed price in terms of the base currency. The gold standard might be regarded as a special case of "fixed exchange rate" policy, or as a special type of commodity price level targeting.

The minima! gold standard would be a long-term commitment to tighten monetary policy enough to prevent the price of gold from permanently rising above parity. A full gold standard would be a commitment to sell unlimited amounts of gold at parity and maintain a reserve of gold sufficient to redeem the entire monetary base.

Today this type of monetary policy is no longer used by any country, although the gold standard was widely used across the world between the mid-19th centuries through 1971. Its major advantages were simplicity and transparency. The gold standard was abandoned during the Great Depression, as countries sought to reinvigorate their economies by increasing their money supply. The Bretton Woods system, which was a modified gold standard, replaced it in the aftermath of World War II. However, this system too broke down during the Nixon shock of 1971.

6. What is District Central Cooperative Bank (DCCB)?

Ans :

The initial co-operative legal framework enacted in the year 1904 did not contemplate the establishment of federal or central co-operatives to function as financing agencies for the primary co-operatives. However, the need for the institution of such second-tier co-operatives, with co-operatives as its members was felt. Accordingly, the enactment of the Co-operative Societies Act, 1912 was made which permitted the establishment of higher federal or central co-operatives.

Thereafter, the primary co-operative credit societies functioning in specified areas federated themselves into collective banking activities, giving birth to central co-operative banks with the prime objective to mobilize funds from urban outlets and divert the same to the rural societies. Gradually, over a period of time, every district in a state started having one or more cooperative bank. This reorganized them at district level to form District Central Co-operative Banks (DCCBs).

7. Regional Rural Banks.

Ans :

Regional Rural Banks are government owned scheduled commercial banks of India that operate at regional level in different states of India. These banks are under the ownership of Ministry of Finance, Government of India. They were created to serve rural areas with basic banking and financial services.

The RBBs Act has made various provisions regarding the incorporation, regulation and working of RRBs. According to this Act, the RRBs are to be set-up mainly with a view to develop rural economy by providing credit facilities for the purpose of development of agriculture, trade, commerce, industry and other productive activities in the rural areas.

Such facility is provided particularly to the small and marginal farmers, agricultural laborer's, artisans, and small entrepreneurs and for other related matters.

The Government of India appointed the Narasimham Committee in July 1975 to set up the new institutions in order:

- To provide employment to the rural educated youth; and
- To bring down the cost of rural banks by recruiting their staff on the same scale of pay and allowances as for the employees of State Government/Local bodies.

8. Objectives of RRB's.

Ans :

The objective of regional rural banks is to develop the rural economy by providing credit and other facilities for agriculture and other productive activities in rural areas. They provide these facilities to small and marginal farmers, rural artisans, agricultural laborer's and other small entrepreneurs working in the rural areas.

The objectives of RRBs can be summarized as follows:

- To provide loan for backward class public
- To opening branches of bank in rural areas.
- To save the rural poor from the moneylenders.
- To cultivate the banking habits among the rural people and mobilize savings for the economic development of rural areas.
- To increase employment opportunities by encouraging trade and commerce in rural areas.
- To encourage entrepreneurship in rural areas.
- To cater to the needs of the backward areas which are not covered by the other efforts of the Government?
- To develop underdeveloped regions and thereby strive to remove economic dispar-ity between regions.
- To increase employment opportunities by encouraging trade and commerce in rural areas.

9. What are the functions of RRB's.

Ans :

The functions of RRB can be summarized as follows:

- Providing of loans and advance to the farmers and other person already engaged in agriculture activities.
- Providing of loans and advance to the co-operative societies and other society which are involved in agriculture processing.
- Accepting the various types of deposits from the rural and other connected areas.
- providing loans and advances to small entrepreneurs and others who are engaged in trade, commerce and industry.
- Setting up and Maintenance of godowns and warehouse.
- Reducing the dependency of weaker section of money lenders.
- Undertaking of the supply of agricultural inputs & equipment's to farmers.

10. Define NABARD.

Ans :

National Bank for Agriculture and Rural Development (NABARD) is an apex development bank in India, having head quarters in Mumbai and other branches are all over the country. The committee to review arrangements for institutional credit for agriculture and rural development setup by RBI, Conceived and recommended the establishment of National Bank for Agriculture and Rural Development.

NABARD was established on July 12,1982 by a special Act of Parliament. Its main focus was on upliftment of rural India by increasing the credit flow or elevation of agriculture and rural non-farm sector. It has been entrusted with matters concerning policy, planning and operations in the field of credit for agriculture and other economic activities in rural areas in India.

11. Explain the objectives of NABARD.

Ans :

The main objects of NABARD are as follows:

1. NABARD provides refinance assistance for agriculture, promoting rural development activities. It also provides all necessary finance and assistance to small scale industries.
2. NABARD in coordination with the State Governments, provides agriculture.
3. It improves small and minor irrigation by way of promoting agricultural activities.
4. It undertakes R&D in agriculture, rural industries.

5. NABARD promotes various organizations involved in agricultural production by contributing to their capital.

12. IDBI

Ans :

Industrial Development Bank of India (IDBI) established under Industrial Development Bank of India Act, 1964, is the principal financial institution for providing credit and other facilities for developing industries and assisting development institutions.

Till 1976, IDBI was a subsidiary bank of RBI. In 1976 it was separated from RBI and the ownership was transferred to Government of India. IDBI is the tenth largest bank in the world in terms of development. The National Stock Exchange (NSE), the National Securities Depository Services Ltd. (NSDL), Stock Holding Corporation of India (SHCIL) are some of the Institutions which has been built by IDBI.

13. SIDBI

Ans :

Small Industries Development Bank of India (SIDBI) was established as wholly owned subsidiary of Industrial Development Bank of India (IDBI) under the Small Industries Development of India Act, 1989. It is the principal institution for promotion, financing and development of industries in the small scale sector. It also coordinates the function of institutions engaged in similar activities.

Objectives

a) Initiating steps for technological upgradation and modernization of existing units

b) Expanding the channels for marketing the products of the small scale sector

c) Promotion of employment-oriented industries, especially in semi urban areas to create more employment opportunities and thereby checking migration of population to urban areas.

14. Development Banks.

Ans :

The concept of development bank is of recent origin in the field of industrial finance. The emergence of bank (DFIs) is a post-independent phenomenon in India. These are the specialized banks which provide all types of medium and long-term financial assistance to business units.

Development bank had a long period of evolution in the Western countries. The origin of development bank may be traced to the establishment of 'Societa Generale Pour Favoriser Industrie Nationale' in Belgium in 1822. But the 'Credit Mobiliser' was the notable institution. The 'Credit Mobiliser' was established in 1852 which acted as industrial financier in France.

The Industrial Financial institution of Japan was established in 1920 to meet the financial need of industrial development of Japan. The Industrial Development Financial institution of Canada (1944), the Finance Corporation for Industry Ltd. (FCI) and the Industrial and Commercial Finance Corporation Ltd. (ICFC) of England (1945) were established as modern development banks to provide term loans to industry after the World War II. The U.K. Government has established the Industrial Reorganisation Corporation (IRC) in 1966.

Definitions

The followings are the important definitions of a development bank :

(i) **According to William Diamond** "A development bank have the opportunity to promote enterprises i.e. to conceive investment proposals and to stimulate others to pursue them or itself to carry them through, from 'conception' to 'realisation'."

(ii) **According to A.G. Kheradjou** "A development bank is like a living organism that reacts to the socio-economic environment and its success depends on reacting most aptly to that environment."

(iii) **According to D.M. Mithani** "A development bank may be defined as a bank concerned with providing all types of financial assistance (medium as well as long-term) to business units in the form of loans, underwriting, investment and guarantee operations, and promotional activities-economic development in general, and industrial development, in particular."

Choose the Correct Answer

1. Commercial banks performs four major functions. They are Traditional functions, Incidental functions, Core functions and ________. [a]

   a) Ancillary functions b) Letter of credit
   c) Promotional functions d) All

2. The Reserve Bank of India was established on _______. [a]

   a) April 1, 1935 b) July 12, 1982
   c) May 26, 2006 d) September 30, 2005

3. Who works as RBI's agent at places where it has no office of its own? [a]

   a) State Bank of India b) Ministry of Finance
   c) Government of India d) International Monetary Fund

4. Which of the following is true about the functions performed by RBI - [c]

   (i) It is the Bank of Issue (ii) It acts as banker to the Government
   (iii) It is the banker of other banks (iv) It regulates the flow of credit
   a) Both (i) and (ii) b) Both (iii) and (iv)
   c) All the Above d) None of the above

5. Which among the following is incorrect ? [d]

   a) RBI is the Bank of Issue
   b) RBI acts as Banker to the Government
   c) RBI is Banker's Bank
   d) RBI does not regulate the flow of credit--

6. India is a member of the International Monetary Fund since _____. [c]

   a) 1934 b) 1935
   c) 1947 d) 1949

7. Which of the following is true about the restrictions on RBI? [c]

   i) It is not to compete with the commercial banks.
   ii) It is not allowed to pay interest on its deposits.
   iii) It cannot engage directly or indirectly in trade.
   iv) It cannot acquire or advice loans against immovable property.
   v) It is prohibited from purchasing its own shares or the shares of any other bank or any company or granting loans on such security.
   a) Only (i),(ii),(iii), and (iv) b) Only (v)
   c) All the above d) None of the above

8. When did the Reserve Bank of India notify the draft regulations relating to the Credit Information Companies (Regulation) Act, 2005? [a]

   a) April 5, 2006 b) May 26, 2006

   c) June 29, 2007 d) September 30, 2005

9. When did the draft guidelines for building grievance redressal mechanism within NBFCs (Non-Banking Financial Companies) publish ? [b]

   a) April 5, 2006 b) May 26, 2006

   c) June 29, 2007 d) September 30, 2005

10. Which financial institution provides refinance facilities? [c]

   a) IFC b) SFC

   c) IDBI d) HDFC

Fill in the Blanks

1. The ________ is given the authority to control all banks from their establishment till their windup.
2. Reserve Bank of India (RBI) is the ________ of India.
3. A ________ is a monetary arrangement that pegs the monetary base of one country to another, the anchor nation.
4. DCCB Stands for ________.
5. ________ are government owned scheduled commercial banks of India that operate at regional level in different states of India.
6. NABARD Stands for ________.
7. IDBI stands for ________.
8. SIDBI stands for ________.
9. The ________ has been playing very important role as a financial institution in providing financial assistance to eligible industrial concerns.
10. SFC stands for ________.

ANSWERS

1. Reserve Bank of India
2. Central Bank
3. Currency Board
4. District Central Cooperative Bank
5. Regional Rural Banks
6. National Bank for Agriculture
7. Industrial Development Bank of India
8. Small Industries Development Bank of India
9. IFCI
10. State Finance Corporations

UNIT III

NEGOTIABLE INSTRUMENTS:

Description - their Special features. Duties, Reprioritizes of paying, collecting banker. Circumstances under which banker and refures payment of cheques. Consequences of wrongful distionous, pre cautions while advancing loans against securities, Good real estate, Insurance polities collateral securities.

3.1 Negotiable Instruments

Q1. Define Negotiable Instruments.

(OR)

What is the meant by Negotiable Instruments?

Ans :

Meaning

Negotiable instruments are the most common credit devices which are freely used in handling commercial transactions. These instruments make possible monetary dealings without using cash balances. These instruments include exchanging documents like bill of exchange, promissory notes, cheques etc. These instruments make possible replacement of currency, paper notes and coins i.e. legal tender money. These instruments create a right in favour of some persons.

A negotiable instrument is a method of transferring a debt from one person to another. The word 'negotiable' means transferable from one person to another in return for consideration and instrument means a written document by which a right is created in favour of some person. Thus, a negotiable instrument is a document which entitles a person to a sum of money and which is transferable from one person to another by endorsement and delivery.

Definitions

i) **According to Section 13 of the Negotiable Instrument Act, 1881 :** "A negotiable instrument means a promissory note, bill of exchange or cheque payable either to order or to bearer."

ii) **According to AccJustice Willis :** "A negotiable instrument is one the property in which is acquired by anyone who takes it bona fide and for value notwithstanding any defect of title of the person from whom he took it."

3.1.1 Features

Q2. State the characteristic features of Negotiable Instruments?

Ans : **(Imp.)**

The Characteristics of Negotiable Instruments includes:

1. Freely Transferable

A negotiable instrument is freely transferable which means that it can be transferred from one person to another easily and no legal formalities are necessary to be complied with a transfer. Usually, when we transfer any property to somebody, we are required to make a transfer deed, get it registered, pay stamp duty, etc. But, such formalities are not required while transferring a negotiable instrument. The ownership is changed by mere delivery (when payable to the bearer) or by valid endorsement and delivery (when payable to order). Further, while transferring it is also not required to give a notice to the previous holder.

Example : S draws a bill on T as, “Pay to T Rs. 80000.” It is a valid negotiable instrument which is freely transferable from A to B.

2. Rights of The Holder

The holder of a negotiable instrument has the right to file a suit in his name for payment from all or any of the concerned parties.

Holder in due course can sue in his own name without giving notice to the debtor (drawer) of his becoming holder. All prior parties are liable to him. A holder in due course can recover the full amount of the instrument.

Example : C signs a negotiable instrument "I promise to B or order Rs. 100,000." It is a valid negotiable instrument where B has the right to recover Rs.100,000 from C.

3. Better Title:

This means that the title of holder is free from all defects and a person who receives a negotiable instrument has a clear and undisputable title to the instrument. However, the title of the receiver will be absolute, only if he has got the instrument in good faith and for a consideration. Also the receiver should have no knowledge of the previous holder having any defect in his title. Such a person is known as holder in due course.

Example : Mr. X sold goods to Mr. Y worth Rs. 100,000 and received a promissory note in return from him. Afterwards B refused to honour promissory note claiming that the goods were not of agreed quality.

1) If Mr. X sues Mr. Y on the pro-note, Mr. Y's defence is good.

2) If Mr. X negotiates pro-note to Mr. Z (who is holder in due course), Mr. Y's defence will be of no avail.

4. Promise or Order

Promise or Order to pay must be unconditional which means that it contains an unconditional promise or order to pay. Negotiable instruments are payable to order which is expressed to a particular person. An instrument which does not restrict its transferability expressly is negotiable whether the word 'order' is mentioned or not. The word 'order' or 'bearer' is no longer necessary to render an instrument negotiable

Example: Mr. A signs a negotiable instrument as "I promise to pay Mr. B or order Rs.100,000."

5. Certain Amount

Payment must be in specific sum of money. This characteristic of negotiable instrument means that the person liable to pay on the instrument has to pay that sum of money mentioned in the instrument and nothing else than that and payment can be asked in currency but not in goods, etc.

Example: Mr. P signs a note to Mr. Q, "I promise to pay Mr. Q Rs. 100,000 on 1st January next" is a valid note.

6. Presumptions

Certain presumptions apply to all negotiable instruments.

a) **Consideration Present :** Every Negotiable instrument is made, or drawn accepted, endorsed, negotiated or transferred for consideration.

b) **Date Drawn :** Date mentioned on the instrument is the date on which it was made or drawn.

c) **Time of Acceptance :** Every accepted bill of exchange was accepted within a reasonable time after its date and before its maturity.

d) **Time of Transfer :** Every transfer of a negotiable instrument was made before maturity.

e) **Order of Endorsement :** Endorsements appearing on the negotiable instrument were made in the order in which they appear thereon.

f) **Stamp Duty :** A lost or destroyed instrument was duly stamped and the stamp was duly cancelled.

g) **Holder :** The holder of negotiable instrument is a holder in due course.

h) **Proof of Protest :** The proof of protest is evidence of dishonour.

7) In Writing : A negotiable instrument needs to be in written form and an oral promise or order is not considered as a negotiable instrument.

Example : A draws a bill on B as, "Pay Rs.50000 to Z or order." (in writing).

Q3. Explain the various parties involved in negotiable instrument.

Ans :

1. Drawer

A person drawing or making a bill of exchange or cheque is known as "drawer".

2. Maker

'Maker' refers to a person who makes a promissory note.

3. Drawee

According to Sec.7, para 1, "A drawee is a person on whose name bill of exchange or cheque is drawn and a person who is instructed to pay a certain sum of money, in case of a cheque, banker is a 'drawee'".

4. Acceptor

In case of bill of exchange, bill is sent to drawee for acceptance. Drawee becomes acceptor after the acceptance of the bill. Drawee signs the bill which is the symbol of acceptance and sends that bill or informs the holder or any other person working on behalf of holder about the acceptance of bill. No acceptance is needed for cheque, as cheque is drawn with an intention of getting quick payment.

5. Payee

As per Sec.7, para 5, "A person whose name is given in a bill of exchange, promissory note or cheque and to whom or on whose demand a certain sum of money is to be paid is known as 'payee'. In case of bill of exchange or cheque, drawer may be the payee. If the payee name specified in a bill is an imaginary one then bill is considered as payable to bearer".

6. Drawee in Case of Need

Apart from the name of the drawee, if any other person's name is given in a bill or endorsement for the purpose of approaching him in case of need then that person is known as "drawee in case of need". "Drawee in case of need" is also known as "referee in case of need" in English law. Drawer or endorser may give the name of drawee in case of need at the time of drawing of bill.

If the name of the drawee in case of need is specified in a bill of exchange or endorsement then the bill will not get dishonoured till the drawer in case of need dishonours it.

7. Endorser

'Endorser' refers to a person who endorses a bill of exchange, promissory note or cheque to another person.

8. Endorsee

'Endorsee' is a person to whom the bill of exchange, promissory note or cheque is endorsed by endorser.

9. Acceptor for Honour

As per the general rule, an unknown person is not supposed to accept a bill. In case, if the bill gets dishonoured due to non-acceptance of drawee, the holder may permit/allow other person to accept the bill to avoid dishonour of the drawer or endorser. The person who is accepting the bill for the honour of the drawer or endorser is known as "acceptor for honour".

10. Holder

Any person can be regarded as the holder of negotiable instruments i.e., promissory note, bills of exchange or cheque if he fulfills the following two conditions,

(a) He should be authorized to the possession of the instrument under his own name and

(b) He should be authorized to recover the amount due on the instrument from the parties which are liable under the instrument.

Hence, the holder refers to the bearer of any negotiable instrument and the endorsee or payee if payable by an order.

Q4. What are the assumptions of negotiable instrument.

Ans :

The following assumptions are included in the section 118 and 119.

1. Order of Endorsements

Endorsements in the negotiable instrument are assumed to be made in the same order as they appear thereafter.

2. Consideration

Consideration is assumed to be very important in each and every negotiable instrument. Negotiable instrument is assumed to be drawn, created, accepted, negotiated, endorsed for some consideration in return. A holder would be able to get the judgement from court very easily if he possesses the negotiable instruments.

3. Proof of Protest

According to section 119, in case of dishonour of instrument, the court assumes the fact of dishonour on the basis of proof of protest providing that fact of dishonour is not proved wrong by any one.

4. Date

A negotiation instrument must have a date and should be drawn on the same as specified on it.

5. Holder Assumed as Holder in Due Course

A holder of a negotiable instrument is assumed as a holder in due course according to Sec. 118.

6. Time of Transfer

Each and every negotiable instrument is assumed to be transferred before the time of maturity.

7. Stamp

If instrument gets misplaced somewhere then it is assumed that instrument has been stamped properly.

3.2 Types of Negotiable Instruments

Q5. Explain different types of negotiable instruments.

Ans : **(Imp.)**

1. Promissory Note

Promissory note is an unconditional document in which the drawer promise to pay the amount stated in it after a definite period or on demand to payee or on his order to the bearer. It is a written promise made by one person to pay certain sum of money due to another person or any other legal holder of the document. According to section 4 of Negotiable Instrument Act, 1881, "A promissory note is an instrument in writing containing unconditional undertaking, signed by the maker, to pay a certain sum of money to, or to the order of a certain person, or to the bearer of the instrument."

2. Bill of Exchange

A bill of exchange, popularly known as a bill is an instrument in writing containing an unconditional order, signed by the maker directing a certain person to pay a certain sum of money only to, or to order of, a certain person of to the bearer of the instrument. It is a written document. It is an acknowledgment of a debt. The creditor prepares a bill of exchange which is accepted by the debtor.

Sec 5 of the Negotiable Instruments Act defines a bill of exchange as an instrument in writing containing an unconditional order, signed by the maker, directing a certain person to pay a certain sum of money only to or to the order of a certain person or to the bearer of the instrument.

3. Cheque

A cheque is a mode of order to the bank by the depositor to make the stipulated payment to the person in whose favour the cheque has been issued. A cheque is an instrument in writing containing an unconditional order signed by the drawer requiring the bank (drawee) to pay on demand a certain sum of money only to or to the order of, a certain person or to the bearer of the instrument.

Section 6 of the Negotiable Instruments Act, 1881 defines a cheque as a bill of exchange drawn upon a specified banker and not expressed to be payable otherwise than on demand.

A cheque is always drawn on specified banker and is always payable on demand. It is to be noted that all cheques are bills of exchange but all bills of exchanges are not cheques.

Bankers provide cheque books to their customers to draw cheques on their accounts for withdrawals or for payment to third parties.

The banker does not refuse to pay the cheque provided :

(a) It is properly drawn and complete in all respects.

(b) The bank has adequate funds to the credit of the customer.

(c) The signature of the customer on the cheque tallies with the specimen signature kept in the bank.

(d) The bank does not doubt about bonafides of the holder.

3.2.1 Promissory Note

Q6. What is meant by Promissory Note? State the characteristics of Promissory Note.

Ans :

Definitions

Section 4 of the Negotiable Instrument Act : "A promissory note is an instrument in writing (not being a banknote or a currency note) containing an unconditional undertaking signed by the maker, to pay a certain sum of money only to, or to the order of a certain person, or to the bearer of the instrument".

The person who promises to pay is called the maker. The person who promises the payment is called the payee.

1. **It Must be in Writing :** A promissory note must always take the form of a written document. Mere verbal promise to pay will not do. The instrument may be written on any paper, on book or any other substitute for paper. The writing may be in pencil or ink. Writing includes printing, photography, and lithography.

2. **The Promise to Pay Must be Express :** The essential of a promissory note is and express promise to pay. A mere acknowledgment of debt without express promise to pay is not a promissory note. A mere implied promise will not do. The words, "I am bound to pay" or "I am liable to pay" only constitute an acknowledgment of liability to pay and do not amount to an undertaking to pay.

3. **The Promise to Pay Must be Unconditional :** A promissory note must contain an unconditional promise to pay. The promise to pay must not depend on the happening of a contingency. A conditional promissory note is not negotiable and hence invalid. A promise to pay 'when able' or as soon as I possibly can' is conditional. But the promise to pay does not become conditional if the amount is made payable at a particular place or after a specified time or on the happening of an event which must happen. Thus, a promise to pay Rs. 500 seven days after the death of B is not conditional for it is certain that B will die though the exact time of his death is uncertain. But a written promise to pay a sum of money within so many days after the marriage of the maker was not recognized as a promissory note because the maker may never marry and the sum may never become payable.

4. **It Must be Signed by the Maker :** The signature of the maker on the face of the note is the most essential feature. In the absence of the signature of the maker, an instrument cannot be called a promissory note. Signing means writing one's name on some document or paper. Such signature need not be at the foot or at any particular part of the promissory note, but it must be so placed as to show that the person signing it is the author of the instrument. It may be a thumb-mark, initials or any other mark. Thumb-mark is sufficient when the maker is illiterate, but when he is able to write this mark will not be sufficient.

5. **The Maker Must be Certain :** The maker of the note must be definite. The note must show on its face the person who is liable as a maker. He may be described by his name or designation. A promissory note may be made by two or more makers, and they may be liable thereon jointly or severally. Where a person signs in an assumed name, he is liable as a maker. A note signed "A or Else B" is not invalid. It is good against A and B but B becomes liable only on default by A.

6. **Promise Must be to Pay a Certain Sum :** The amount promised to be paid by the promissory note must be certain and definite. If the amount to be paid is uncertain the instrument will not operate as a promissory note. The promise must be to pay a definite sum and nothing else. Thus, a promise to pay Rs. 2,000 and such other sums as may be due would not make the promissory note valid, because the amount promised is uncertain.

   The sum promised to be paid does not become uncertain merely because:

   a) There is a promise to pay the amount with interest at a specified rate;

   b) There is a promise to pay compound interest;

   c) The amount is to be paid at an indicated rate of exchange; or

   d) The amount is payable by installments even with a provision that default being made in payment of an installment, the whole shall become due.

7. **The Promise Should be to Pay Money and Money Only :** It is essential that the medium of payment must be money only and not bonds, bills or any other article. Thus, a document containing a promise to pay money and paddy is not a promissory note.

8. **The Payee Must be Certain :** It is essential to the validity of a promissory note that the person who is to receive the money should be capable of being ascertained from the instrument itself. Where a document does not specify the person to whom the money is to be paid, it is not a promissory note. The payee should be certain on the face of the instrument and at the time of execution. The payee must be ascertained by name or by designation. A promissory note payable to the secretary of a club, or a manager of a bank or the principal of a college is regarded as payable to a certain person. A promissory note payable to several individuals is not invalid on the ground of uncertainty. Similarly a promissory note payable to either of the two persons specified therein cannot be said to be uncertain. A bank note or a currency note is not a promissory note as both of them are treated as money itself.

9. **It Should be Dated :** The date of a promissory note is not material unless the amount is made payable at particular time after date. Even then, the absence of date does not invalidate the pro-note and the date of execution can be independently proved. However to calculate the interest or fixing the date of maturity or lm\imitation period the date is essential. It may be ante-dated or post-dated. If post-dated, it cannot be sued upon till ostensible date.

10. **Demand :** The promissory note may be payable on demand or after a certain definite period of time. The rate of interest- It is unusual to mention in it the rated of interest per annum. When the instrument itself specifies the rate of interest payable on the amount mentioned it, interest must be paid at the rate from the date of the instrument.

11. **Other formalities :** Formalities like number, place, attestation, etc., are usually found in the promissory note, but they are not essential to the validity of a promissory note that it should contain the name of the place where it is made or the place where it is payable. Similarly a promissory note under the Indian stamps act and must also be properly cancelled. An unstamped promissory note is not admissible in evidence and no suit can be maintained thereon.

Q7. Explain the parties involved in promissory note. Draw the specimen of promissory note.

Ans :

There are primarily two parties involved in a promissory note. They are,

1. **The Maker or Drawer :** The person who makes the note and promises to pay the amount stated therein. In the above specimen, Sanjeev is the maker or drawer.

2. **The Payee :** The person to whom the amount is payable. In the above specimen it is Ramesh.

   In course of transfer of a promissory note by payee and others, the parties involved may be :

   a) **The Endorser :** The person who endorses the note in favour of another person. In the above specimen if Ramesh endorses it in favour of Ranjan and Ranjan also endorses it in favour of Puneet, then Ramesh and Ranjan both are endorsers.

   b) **The Endorsee :** The person in whose favour the note is negotiated by endorsement. In the above, it is Ranjan and then Puneet.

Specimen of promissory Note

Rs. 3000/-	Mumbai
	5th January, 2005
Three months after date, I promise to pay Mr. Agarwal or order a sum of Rs. 3000/- (Rupees Three thousand only) for value received.	
	Stamp
Mr. Agarwal	S/d
Mumbai	Minakshi.

3.2.2 Bill of Exchange

Q8. What is meant by Bill of Exchange? State the characteristics of Bill of Exchange.

Ans :

Meaning

A bill of exchange is a written unconditional order by one party to another to pay a certain sum, either immediately or on a fixed date, for payment of goods and for services received. The drawee accpets the bill by signing it, thus converting it into a post dated cheque and a binding contract

Definition

According to Section 5 or Negotiable Instrument Act :

"A bill of exchange is an instrument in writing containing an unconditional order, signed by the maker, directing a certain person to pay a certain sum of money only to, or to the order of a certain person or to the bearer of the instrument."

Characteristics of Bill of Exchange

1. **Writing :** It must be in writing and may be in any language and in any form. No particular form of words is necessary. It may be written in ink or pencil or may even be printed or cyclostyled. It may be in any form but the words shall be visible.

2. **Parties :** There must be three parties to the bill of exchange. They are drawer, drawee and payee. The person who draws a bill is called a drawer or maker. The person on whom the bill is drawn is called a drawee and the person to whom the money is to be paid is called a payee.

3. **Order to Pay :** The bill of exchange must contain an order by the drawer to the drawee to pay under any circumstances. The order must be imperative and not in the form of excessive request.

4. **Unconditional :** The order in the bill must be unconditional. It means that it must be payable under all events and circumstances. Promise or order to pay is not conditional simply because the time for payment of amount or any installment thereof being expressed to be payable on the happening of a specified event which is certain to happen although the time of its happening may be uncertain.

5. **Signature :** The bill must be signed by the drawer.

6. **Person Directed i.e., the Drawee Must be Certain :** The order to pay must be directed to a certain person. Certainty of the drawee helps the payee to present the bill for acceptance or payment to a certain person and also helps the drawee to know whether it is addressed to him or not. Drawee must be designated with reasonable certainty.

7. **Money :** The order must be to pay money only.

8. **Payee Must be Certain :** It must be payable to a definite person or his order. The payee must be certain. Bill may be made payable to two or more payees jointly or in the alternative.

9. **Certain Sum :** The sum payable must be certain. The sum payable may be certain although it includes future interest or is payable at an indicated rate of exchange or is according to the course of exchange. Where rate of exchange is not specified, it shall be determined in the course of exchange on its maturity.

10. **Stamping :** Bill of exchange is chargeable with stamp duty.

Q9. Explain the parties involved in Bill of Exchange. Draw the specimen of Bill of Exchange.

Ans :

Parties to Bill of Exchange

There are three parties involved in a bill of exchange. They are

1. **Drawer:** The maker of a bill of exchange is called the 'drawer'.

2. **Drawee:** The person directed to pay the money by the drawer is called the 'drawee'.

3. **Acceptor:** After a drawee of a bill has signed his assent upon the bill, or if there are more parts than one, upon one of such pares and delivered the same, or given notice of such signing to the holder or to some person on his behalf, he is called the ' acceptor'.

4. **Payee:** The person named in the instrument, to whom or to whose order the money is directed to be paid by the instrument is called the 'payee'. He is the real beneficiary under the instrument. Where he signs his name and makes the instrument payable to some other person, that other person does not become the payee.

5. **Indorser:** When the holder transfers or indorses the instrument to anyone else, the holder becomes the 'indorser'.

6. **Indorsee :** The person to whom the bill is indorsed is called an 'indorsee'.

7. **Holder :** A person who is legally entitled to the possession of the negotiable instrument in his own name and to receive the amount thereof, is called a 'holder'. He is either the original payee, or the indorsee. In case the bill is payable to the bearer, the person in possession of the negotiable instrument is called the 'holder'.

8. **Drawee in Case of Need :** When in the bill or in any endorsement, the name of any person is given, in addition to the drawee, to be resorted to in case of need, such a person is called 'drawee in case of need'. In such a case it is obligatory on the part of the holder to present the bill to such a drawee in case the original drawee refuses to accept the bill. The bill is taken to be dishonoured by non-acceptance or for nonpayment, only when such a drawee refuses to accept or pay the bill.

9. **Acceptor for honour :** In case the original drawee refuses to accept the bill or to furnish better security when demanded by the notary, any person who is not liable on the bill, may accept it with the consent of the holder, for the honour of any party liable on the bill. Such an acceptor is called 'acceptor for honour'.

Specimen of Bill of Exchange

Rs. 10,000/- Mumbai 12th November, 2012 Three months after date pay to XYZ, or order the sum of ten thousand rupees for value received. To, ABC, Juhu Road, Mumbai. Signed PQR

3.2.3 Cheque

Q10. What is meant by Cheque? State the characteristics of Cheque.

Ans :

Meaning

A cheque is a document that orders a payment of money from a bank account. The person writing the cheque, the drawer, usually has an account where their money was previously deposited. The drawer writes the various details including the monetary amount, date, and a payee on the cheque, and signs it, ordering their bank, known as the drawee, to pay that person or company the amount of money stated.

Definition

According to Section 6 Negotiable Instrument Act.:

"Cheque is an instrument drawn on specific banker, ordering to pay specific amount, to a specific person, after the specific date." A cheque is also a bill of exchange, and it has two important features :

1. It is always drawn on specific banker by an account holder.
2. It is always payable on demand. This instrument has also three parties-drawer, drawee and payee. It is also an unconditional order on the banker.

Characteristics of Cheque

The Characteristics of cheque are given below:

1. **Instrument in Writing:** A cheque must be an instrument in writing. Oral orders, although they may have the other requisites, cannot be treated as cheques. It may be in any language and in any form. It may be written in ink or pencil or may even be printed or cyclostyled. It may be in any form, but the words must be visible.
2. **Unconditional Order:** Cheque must contain definite and an unconditional order to pay. A conditional instrument is invalid. For instance, if the cheque has a receipt form attached to it and the following words are added, "provided the receipt form at the foot is duly signed and dated," or if the amount is made payable out of a particular fund, the order will be regarded as conditional and hence the instrument containing such a direction cannot be regarded as a cheque.
3. **On a Specified Banker Only:** The instrument must be drawn on a specified banker. This means, firstly, that it should be drawn on a banker and not on any other person. Secondly the name and preferably also the address of the banker should be specified.
4. **Certain Sum of Money Only :** The order must be only for the payment of a certain sum of money only. It is clear that orders asking the banker to deliver securities or certain other things cannot be regarded as cheque. It must also be noted that the sum of money to be paid must be certain.

5. **Amount of Cheque:** It is necessary to mention clearly the amount of money which the drawer desires his banker to pay. The sum is usually stated in words as well as in figures so as to avoid mistakes. No blank space should be left on the cheque before and after the amount stated in words and in figures.

6. **Payee to be Certain :** In order that an instrument shall be a valid cheque, it should be made payable to or to the order of a certain person or the bearer. The payee must be certain.

7. **Signature :** The cheque must be signed by the drawer.

Q11. Explain the parties involved in Cheque.

Ans :

Here are three parties involved in a cheque. They are as follows:

1. **Drawer:** Drawer is the party who draws the cheque upon a specified banker. He is the maker of the cheque. He is the account holder who draws the cheque for drawing money from his bank account. He is the person who issues cheque directing the bank to pay a certain sum of money to a certain person or to the bearer. Thus, the person who signs the cheque is known as drawer.

2. **Drawee:** Drawee is the party upon whom the cheque is drawn. Drawee is the bank. It is the party to whom the drawer gives order to pay the amount to the person named on the cheque or his order to the bearer. When the bank follows the order and pays the amount of the cheque then the cheque is said to be honored. In case of refusal of the order, the cheque is said to be dishonored.

3. **Payee :** Payee is the party who presents the cheque for payment. He is the person who receives money from bank. He is the party in favor of whom cheque is issued. The payee is the person whose name is mentioned on the cheque. If the cheque is made payable to self, the drawer himself becomes the payee.

Q12. Explain different types of Cheque.

Ans : **(Imp.)**

Types of Cheque

Cheques are of following types :

1. **Bearer Cheque :** Generally, the cheque indicates the name of a person to whom the amount is to be paid. He is called the payee, paying bank is the drawee and the person who draws the cheques is the drawer. In case of bearer cheque, the wording of the cheque is pay to or bearer. It is not necessary for the payee to personally present the cheque and get the money. He can sign on the back and hand it over to any other person. Any person who holds the cheque lawfully can get payment. The person who presents the cheque is called the bearer. Bank is not bound to verify the identity of the bearer. Thus, any bearer cheque lost or stolen is likely to be presented for payment. There is nothing to pin joint the identity of the person who accepted payment. Anybody who comes in possession of the cheque can encash it. Thus, bearer cheques are somewhat risky.

2. **Order Cheque :** An order cheque specifically instructs the banker to ensure that the person mentioned only receives payment. The bank is duly bound to verify the identity of the person and see that the person presenting the cheque is the person whose name is mentioned on the cheque. If the word 'bearer' is struck off, the cheque becomes order cheque. Thus, the order cheque is safer than the bearer cheque. If both the words i.e 'bearer' and 'order' are cancelled, the cheque becomes not negotiable, i.e. it cannot be legally transferred to any other person.

3. **Crossed Cheque :** When two parallel lines are drawn on the top left side of the cheque, it is called crossed cheque. The lines should be conspicuous. The lines may or may not contain the words '& Co'. When a cheque is crossed, the payment is not made across the counter but the amount is credited to the payee's account. He can then withdraw the amount from his account. A crossed cheque is an express instruction to the banker not to make cash payment. This is the safest type of cheque. This is called general crossing.

Sometimes, name of a specific bank and branch is written between the lines. It means the cheque must be presented through that bank only. This is called special crossing. In such case, the amount is paid to the specific bank which in turn credits the amount to the payee's account. The words 'not negotiable' between the lines destroy the negotiability of the cheque.

4. **Uncrossed/open cheque :** When a cheque is not crossed, it is known as an "Open Cheque" or an "Uncrossed Cheque". The payment of such a cheque can be obtained at the counter of the bank. An open cheque may be a bearer cheque or an order one.

5. **Anti Date Cheque :** If a cheque bears a date earlier than the date on which it is presented to the bank, it is called as "anti-dated cheque". Such a cheque is valid upto six months from the date of the cheque. For Example, a cheque issued on 10th Jan 2010 may bear a date 20th Dec 2009.

6. **Post-dated Cheque :** If a cheque bears a date which is yet to come (future date) then it is known as post-dated cheque. A post dated cheque cannot be honoured earlier than the date on the cheque. For example, if a cheque presented on 10th Jan 2010 bears a date of 25th Jan 2010, it is a post-dated cheque. The bank will make payment only on or after 25th Jan 2010.

7. **Stale Cheque :** If a cheque is presented for payment after six months from the date of the cheque it is called stale cheque. A stale cheque is not honoured by the bank.

8. **Multilated Cheque :** When a cheque is torn into two or more pieces and presented for payment, such a cheque is called a mutilated cheque. The bank will not make payment against such a cheque without getting confirmation of the drawer.

Q13. Compare and contrast Promissory note and bill of exchange.

Ans : **(Imp.)**

S. No.	Points	Promissory Note	Bill of Exchange
1.	**Number of Parties**	**Two Parties** i) Drawer ii) Drawee	**Three Parties** i) Maker ii) Payee iii) Payee
2.	**Payee**	Maker of a promissory note can't be the payee.	Drawer and payee may be the same person.
3.	**Promise and Order**	It is a promise to make the payment.	It is an order for making the payment.
4.	**Acceptance**	Requires no acceptance as it is signed by the person who is liable to pay.	Must be accepted by the drawee before it can be presented for payment.
5.	**Nature of Liability**	Liability of the maker is absolute and primary.	Liability of the drawer is secondary conditional. It arises only and when acceptor dishonours the bill.
6.	**Payable to Bearer**	A promissory note can't be drawn 'payable to bearer' it is not drawn 'payable to bearer on demand.'	A bill of exchange can be so drawn provided.
7.	**Notice of Dishonour**	Notice of dishonour is not necessary.	Notice of dishonour must be given by 'holder' to all prior parties who are liable to pay.

8.	**Nature of Payment**	It contains an unconditional promise to pay.	It contains an unconditional order to pay.
9.	**Protest**	No protest is required.	A foreign bill must be protested for dishonour when such protest is required by the law of the place where it is drawn.
10.	**Exemption**	Provisions relating to present ment for acceptance, acceptance for supra protest do not apply.	These provisions apply.

Q14. Compare and contrast Cheque and bill of exchange.

Ans : **(Imp.)**

S.No.	Points	Cheque	Bills of Exchange
1.	**Definition**	Cheque is a negotiable instrument. It is an unconditional order given in the prescribed form by an account holder to its bankers to pay a person or order or bearer a certain sum of money.	A bill of exchange is an instrument in writing, containing an unconditional order, signed by the maker, directing a certain person to pay a certain person or to the bearer of the instrument.
2.	**Drawee**	Only a banker can be a drawee.	Any one can be a drawee, including a banker.
3.	**Acceptance**	A cheque requires no acceptance.	It must be presented for acceptance. Drawee is liable only after his acceptance.
4.	**Payment**	Payable on demand without any days of grace.	A bill is normally entitled to three days of grace after maturity, unless payable on demand.
5.	**Presentment**	If not presented to the banker for payment, it does not discharge the drawer unless he suffers injury or damages.	Drawer is discharged, if bill is not presented for payment to the acceptor.
6.	**Notice of dishonour**	In case of dishonour, no notice of dishonour is necessary.	Notice of dishonour is to be given to all the parties liable to pay.
7.	**Crossing**	A cheque may be crossed.	Bill of exchange can never be crossed.
8.	**Stamp**	Cheque requires no stamp.	Bill must be properly stamped.
9.	**Counter manding Payment**	Payment of cheque may be countermanded by the drawer.	Payment of the bill cannot be countermanded by the drawer.
10.	**Noting and Protesting**	A cheque is not required to be noted or protested for dishonour.	A bill may be noted or protested for dishonour.
11.	**Payable to Bearer on Demand**	It can be drawn so.	It cannot be drawn so.

3.3 Paying Banker

Q15. Define paying banker. State the duties of paying banker.

Ans : **(Imp.)**

The banker on whom the cheque is drawn or the banker who is required to pay the cheque drawn on him by a customer is called the Payment Banker or Drawee Banker. The banker who is liable to pay the value of a cheque of a customer as per the contract, when the amount is due from him to the customer is called 'Paying Banker'. The payment to be made by the bank has arisen due to the contractual obligation. Paying Banker is also known as drawee bank as the cheque is drawn on him. The payment has to be made by the banker as per the legal obligation.

Duties of Paying Banker

The paying banker should bear in mind the following duties before passing or dishonouring a cheque. These duties are also called the mandatory functions of a paying banker.

These are as follow :

1. **Proper Form:** The cheque presented for payment should be in proper form. The paying banker should see the whether the cheque satisfies all the requirements of a valid cheque or not. The cheque must be in printed form supplied by the banker in specific format. It should also be in unconditional order. If a conditional cheque is drawn, it is not at all a cheque and cannot be paid. Thus, it is duty of paying banker to return the cheque with the remark. Cheque not in proper form, if a cheque is presented for payment in an improper form.

2. **Physical Condition:** The cheque should be in good physical condition. It is the duty of a paying banker that the instrument should not be torn, mutilated or cancelled. If torn intentionally to cancel the crossing etc. the banker cannot know the reason as to why it is torn. Hence, the banker should return the cheque for conformation of the drawer. If he cannot get the confirmation of drawer, he can return the cheque marked 'Mutilated cheque'. Similarly, if the main contents *i.e.* name, amount, date etc., are cancelled, the banker should return the cheque refusing the payment.

3. **Crossing:** It is the duty of paying banker to examine whether the cheque received for payment is an open cheque or a crossed cheque. If the cheque is a crossed cheque, the payment cannot be made across the counter. It has to pass through the account holder. In case of crossed cheque, the banker has another duty to observe whether it is a generally crossed cheque or specially crossed cheque.

4. **Office of Drawing:** When a cheque is presented for payment, it is the duty of pay in banker to see the account whether it is kept in the same branch or any other branch of the same bank. If a customer presents a cheque in a branch where he does't hold an account, the manager cannot make payment as he is not aware whether cheque is genuine or a forged one.

5. **Date of the Cheque:** It is the duty of paying banker to see the date of the cheque. The cheque should possess a date for payment and only on that date or within six months from the date, the payment should be made. The cheque should comprise of year, month and date. Cheques bearing incomplete date or impossible date like April 31st etc., should not be honoured.

6. **Time of Presentation:** The cheque presented during the banking hours should be honoured. The point to be noted here is that the cheque should be presented for payment during the banking hours. However, stale cheque can be paid after banking hours. Here, the presentation cheque is more important than payment.

7. **Amount:** The amount of cheque presented for payment has to be recorded in both words and figures and they should tally with each other.

3.4 Collecting Banker

Q16. Define collecting banker. State the duties and responsibilities of a collecting banker.

Ans :

As per Section 131 of Negotiable Instrument Act 1881. "A banker who has in good faith and without negligence received payment for a customer of a cheque crossed generally or specifically to himself shall not, in case the title to the cheque proves defective, incur any liability to the true owner of the cheque by reason of only having received such payment.

Duties and Responsibilities of a Collecting Banker

A banker entrusted by his customer with the customer with the collection of a cheque is bound to act according to the directions given by the customer, and in the absence of such direction according to the usages prevailing at the place, where the banker conducts his business and applicable to the matter in hand. The banker is also bound to use reasonable skill and diligence in presenting and securing payments of the cheque and placing the proceeds to his customer's account and in taking such other steps as may be proper to secure the customer's interest.

Thus, a collecting banker has the following duties towards his customer :

1. **Exercise Due-Care and Diligence :** Banker should exercise due care, diligence and skill in collection of cheques. Collecting banker must observe utmost care while presenting the cheque for collection. The banker should not be negligent while discharging his duty as the agent of the customer.

2. **Present Cheque for Collection in Time** : Collecting banker must present the cheques for payment to the drawee bank within a reasonable time. Generally, if the collecting and paying banker are in the same place, the cheque should be presented by collecting banker by the next day. To outstation cheques should be dispatched for collection by the next day on the day when it has received by collecting banker.

3. **Notice to Customer in case of Dishonour of Cheque :** The collecting banker must serve a notice of dishonour to customer within a reasonable time. Collecting banker will held be liable for the loss, if he fails to serve such notice. The banker should give notice of dishonour to the customer by returning the cheque with a covering letter and enclosing the objection memo which contain reason for dishonour. If the collecting bank is a holder for value, he has to give notice to all the parties to the cheque apart from the customer. The notice of dishonour may be given orally or in writing. It may be given in person or by post within a reasonable time.

Q17. What are the precautions to be taken by a Collecting Banker.

Ans :

In order to avoid the risk of loss, the collecting banker must take following precautions in collecting cheques of his customers :

1. **Collection for a customer:** Collecting bankers should have to receive the payment only for a customer and not for the stranger.

2. **Agent of Customer:** Collecting banker must receive the payment as an agent of the customer.

3. **Checking of Regularity of Endorsement:** The cheque should be closely studied by checking the regularity of endorsement and correctness of other contents like date, amount in words and figure, signature etc. of the cheque.

4. **Good faith:** Collecting banker must act in good faith and without negligence.

5. **Crossing** : Cheque must be crossed before it came under the possession of collecting banker.

3.5 Circumstances under which Banker Refuses Payment of Cheques

Q18. Discuss the Circumstances in which a banker should refuse the payment cheques.

Ans : **(Imp.)**

A banker can refuse the payment in the following special circumstances :

1. **Countermanding order by the drawer** : The drawer of the cheque may in writing instruct his banker to stop payment on a particular cheque giving particulars of the number of the cheque, date and payee. A banker should make a note of the instructions and refuse payment on that cheque when presented. He cannot debit the customer's account with the amount of cheque, which is countermanded. A bank could be sued as much for failing to honour a cheque as for crashing a cheque that had been stopped.

2. **Stop payment order** : It may be given by the drawer either orally or telephonically or in writing.

3. **On the death of a customer** : On the death, the title to his bank balance passes to his legal representatives. Hence, as soon as the banker comes to know about the death of the customer, he has to stop payments of the cheques presented by him after death. It was held by supreme court in United Bank of India V. Smt. Kanan Balo Devi and others, that notice about the death of a customer to one branch is no notice to the other branches. Hence, such notice should be given to other branches also where the customer holds account.

4. **On receipt of notice of Insolvency** : When the banker receives notice of insolvency of customer he has to stop the account of customer. After an order of adjudication is made, the property of the insolvent gets vested in the hands of official assignee or the official receiver.

5. **Notice of insanity :** When the banker receives notice of insanity of a customer, he should stop the account of the customer. If the customer is moved to a lunatic asylum or when a court by an order declares the customer incapable to manage his affairs the bank will be justified in dishonouring the customer's cheque.

6. **Notice of assignment receipt:** When a person transfers a right, property or debt to another person, it is called assignment. The person who assigns such right, property or debt is called assignor. The person to whom assignment is made is called assignee. On receiving the notice of assignment of the customer, the banker can refuse payment of a cheque. The assignment takes effect only after the bank has received an express notice in this regard.

7. **Breech of trust**: In case of a trust account, if the banker comes to know that the customer intends to use the funds in breech of trust, he can refuse payment of cheques.

8. **Defect in title :** If the banker comes to know of any defect in the title of the party presenting cheque, he can refuse payment.

9. **Notice of a Garnishee order** : As the banker and customer have debtor-creditor relationship, the credit balance in a customer's account represents a debt due to him from the banker. When a person obtains a decree as the judgement creditor from the court against the customer, he can attach the debt in execution. The banker on whom such an order is served is called the garnishee. The banker has to comply with the court restraining him from paying the money from a customer's account. Once the Garnishee order is received, the banker must refuse payment of the cheque presented.

3.6 Consequences of Wrongful Dishonour of Cheques

Q19. Discuss the Consequences of Wrongful Dishonour of Cheques.

Ans : **(Imp.)**

i) According to the Indian Contract Act, 1872, if a bank dishonours a cheque inspite of having sufficient funds needed for payment then the bank is liable to pay compensation to the customer due to breach of contract and as a result of damage to the customers reputation.

ii) A customer can claim special damages if loss of reputation as well as business has occurred.

iii) As reputation loss is not measureable in monetary terms the court of law may order the bank to pay for the special damages.

iv) In section 31 of the Negotiable Instruments Act, 1881, it is mentioned that loss or damage implies losses like actual loss as well as injury to reputation or loss of credit.

v) Hence, the customer may claim substantial damages by showing his credit loss due to the dishonour even if there is no actual pecuniary loss.

vi) A trader customer is entitled to claim substantial damages with or without any proof of a special damages or losses.

vii) Whereas a non-trader customer is not entitled to claim substantial damages if there is no proof of special damages or losses suffered.

viii) A good case in point is the Gibbons verses Westminister Bank. In this case, the tenant Mrs Lawrence J. Gibbons paid a cheque for £ 9 drawn on Westminister Bank to her land lady for the payment of monthly rent. The bank erronously dishonoured the cheque.

ix) The court ordered the bank to pay a nominal damage of 40 shillings as she was a non trader and thus there was no case of damage to her reputation, which may attract special damages to be paid.

3.7 Loans and Advances

Q20. What do you mean by loans and advances. Explain various types of loans and advantages.

Ans :

According to Section 5(n) of the Banking Act, 1949, a secured loan or advance is “loan or an advance made on the security of assets the market value of which is not at any time less than the amount of such loan or advance”.

Loans and advances constitute by for the most important revenue of investment of banker’s resources and are the principal source of profit. Other sources of income such as bank commission and charges are small sources.

Types of Loans and Advances

According to the needs and requirements of customers, commercial banks provides different types of loans and advances as follows,

1. Demand Loan

These loans are sanctioned against goods and documents of title of goods, banks own fixed deposit, gold ornaments. These loans are for short period.

2. Term Loan

A bank loan with a floating interest rate and which is repaid over a specific period of time i.e., from 1-10 years is known as term loan.

It ranges from 1 to 5 years medium term, 5 to 10 years long term.

3. Cash Credit

Cash credit is one of the facility which is provided by the banker wherein, the borrower is allowed to withdraw the amount upto a particular limit. The customer’s account is credited with the amount and he can make the withdrawals as per his needs. The bank usually charges interest on amount which is withdrawn and not on the complete amount which is being credited to the borrower’s account. In cash credit, the banker clearly mentions a particular limit of loan for the customer, which is termed as cash credit limit. If suppose the customer maintains the account properly, then cash credit limit would be renewed by the bank at the year ending.

4. Overdraft

The term ‘Overdraft’ refers to the act of overdrawing from bank account. In overdraft, the account holder is enabled of withdrawn amount which is usually more than the credit balance in his/ her account. This facility is basically given for a shorter period of time to those customers who carry out their transactions via Cheques. Overdraft facility is usually given on security on assets or on personal security.

5. Discounting of Bills of Exchange

Bill discounting is another type of facility which is usually provided by discounting the general trade bills i.e., doing the payment prior to the due date of bills and after excluding a particular discount rate. On due date, bank submits the bill to the borrower's customer and collects the complete amount. In case, if the bill is dishonoured then bank collects the amount along with interest from the borrower or his customers. Bill discounting is an advance which is given for security of bill. Bank verifies the creditworthiness of drawer and genuineness of the bill before discounting it.

3.8 Precautions to be taken while Advancing Loans Against Securities

Q21. Explain briefly about advances against stock exchange. State the precautions to be taken buy a banker while advances against stock exchange.

Ans :

It is an organized market where securities are sold and purchased. The following securities are traded on the floor of stock exchange,

(i) Companies shares and debentures

(ii) Central and state government bonds

(iii) Securities such as port trusts, improvement trusts, electricity boards etc, issued by semi-government authorities.

Precautions while Advancing Against Stock Exchange Securities

The following precautions must be taken by the banker while making advances against stock exchange securities,

1. Securities Selection

Before selecting securities a banker must examine the approved list of securities which has to be dealt on the stock exchange. The banker must study the audited profit and loss and balance sheets, the progress and working of all companies and constitution of companies board of directors. Based on the above study, the banker must prepare a list of securities against stock exchange on which advances will be made.

2. Valuation of Securities

After the selection of securities, the banker will determine the value of shares and securities. Securities are taken at their market value and shares prices are quoted cum dividend. Dividends are deducted from the present market value.

3. Equal Margins

The banker must keep equal margins against securities inorder to avoid any losses due to heavy fall in the prices of securities.

4. Preference Shares and Debentures

The banks must go for preference shares and debentures, government and semi-government securities because their price fluctuations are very less.

5. Partly-Paid Securities

A banker must not advance for partly-paid securities.

In case of highly credit worthy customer, the bank can provide loan against partly-paid securities. In this regard the bank must take an undertaking from such customer to pay the call, if made by the company.

6. Transfer of Securities

In case of bearer and negotiable securities the banker will get the title by mere delivery. In case of registered securities, a transfer deed is prepared by the bank and must be signed by the customer. At the time of repayment of loan the shares are transferred to the customer. If the customer is unable to repay the loan, the banker will fill the dummy transfer deed duly signed by the customer, register in its own name and later sell the securities to make the loan amount.

7. Notice to the Company

A banker will issue a notice to the company regarding its interest in the shares of the company. This will reduce the risk of duplicate certificate by the company.

3.9 Precautions to be taken while Advancing Loans Against Real Estate

Q22. Explain briefly about advances against real estate. What are the causes of refusing real estate as a security by a bank?

Ans :

Advances Against Real Estate

Commercial banks does not prefer to grant loan against real estates because it involve heavy risk. In case when the customer do not have any other security to offer, then only the banks accept real estate as security. As the name indicate "real estate" are immovable properties including tangible assets such as land, building etc.

Causes of Refusing Real Estate as Security

The following are the causes of refusing or drawbacks of real estate as security,

1. **Customer's Title**

   The major drawback while advancing against real estate is customer's title. It becomes difficult for the banker to know the customer's interest in the property. In case of agricultural land as security, the banker has to spend more money and time to verify the customer's title and on the other hand the property will be a disputed one.

2. **Large Expenses**

   A customer will take long term loan against real estate as he has to spend large amount in mortgaging the property.

3. **Valuation**

   Valuation of property is another major demerit for banks. The banks has to appoint qualified valuers to value the construction and location of immovable property which is another expense for banks.

4. **Property Administration**

   As a mortgagee of the property, the banks need to maintain property account, administer it and collect rent of land and building.

5. **Legal Formalities**

   There are many legal formalities to be carried out in advancing against real estate like preparation of mortgage deed, its registration, stamp duty payment etc.

6. **Delay in Realization**

   When the customer fails to repay the loan amount, the banker does not able to realize the property amount instantly, because there are many formalities involved in the sale of mortgaged property. The banker needs to wait for many months in order to get back the money.

7. **Maintenance**

   The banker has to look after the mortgaged property and spend more on its maintenance when the customer fails to repay the loan amount.

Q23. What are the precautions to be taken by a bank while lending money against the security of real estate?

Ans :

1. **Title Verification**

   While advancing against real estates as security, the banker should verify the title deeds through its solicitors and find out whether the property is disputed or not.

2. **Land Tenure Charges**

   The banker must have the knowledge of mortgaged property, whether the land is freehold, leasehold or state- owned and what are the charges involved in the tenure of land.

3. **Property Valuation**

   The banker must appoint expert valuers to value the property because he may not able to value the mortgaged property carefully. The valuation involves,

   (i) Property location

   (ii) Right of ownership

   (iii) Rental value

   (iv) Type of construction

   (v) Land size and structure.

4. Insurance Cover

The bank should confirm whether the mortgaged property has a insurance cover against fire and other calamities. The policy must be assigned in favour of bank only.

5. Tax and Rent Payment

Before granting loan against real estates as security, the banker must get all the rent payments and tax payments receipts of property from the customer along with the title deeds and verify whether all dues are cleared or not.

6. Clearance of Income Tax

The banker must get the property clearance certificate from the customer issued by the income tax office. According to Sec. 230 (A) of Income Tax Act, 1961, registration of property (apart from agricultural land) is to be valued at above ` 50,000/-.

3.10 Precautions to be taken while Advancing Loans Against Insurance Policies

Q24. Explain briefly about advance against life insurance policies. State the precuations to be taken by a banker while accepting life insurance policies as a security.

Ans : **(Imp.)**

The bankers may accept life insurance policies as a gcurity or a supplementary security. Supplementary security is very beneficial as it cover the signature by the life of the guaranter. On the other hand, in case of life insurance policy as a main security, the banker may advance 80% to 90% of its surrender value. In India life insurance policies are carried out by LIC (Life Insurance Corporation) of India. They offer many policies such as whole life policy, joint life policy, money back policy etc. 90% of surrender value for the policies in force. 85% of surrender value for paid up policy.

Precautions in Advancing Against Life insurance Policies

The following precautions must be taken by the banker in advancing against life insurance policies,

1. Favoured Endowment Policy

The banker must accept endowment policy while advancing against life insurance policy as security because it contains a definite maturity rate. If he accept a whole life policy then he has to wait for a longer period of time to realize his money.

2. Age of Insured

Age of insured duly admitted by the LIC of India must be carefully examined by the banker before granting against lie insurance policy.

3. No Restrictions on Assignment of Policy

The banker must carefully check that there are no restrictions on assignment of policy before granting loan against life insurance policy.

4. Margin

The banker must set the margin of 80% to 90% of the surrender value of the policy. He can increase the percentage I af loan, incase of endowment policy when he is satisfied that I the policy premium is regularly paid.

5. Interest of Insurance

Interest of insurance is needed for the validity of insurance policy. Interest is contained for the following cases,

(i) In case of husband in the life of his wife.

(ii) In case of wife in the life of his husband.

(iii) In case of any other person in his/her life.

6. Certain Policies

The banker should not grant loan against the policies which comes u/s 6 of the Married Women's Property Act. Because such policies are not legally assigned.

3.11 Precautions to be taken while Advancing loans Against Collateral Securities

Q25. Define Collateral Securities. Explain different types of Collateral Securities.

Ans :

These are substantial securities pledged by the customer to secure loan from banks raw materials, goods and other assets are regarded as collateral securities, the banks will grant loan and advances against them.

Forms of Collateral Securities

The different forms of collateral securities are,

1. Lien
2. Pledge
3. Mortgage

1. Lien

It is stated in under section 171 of contract Act, 1872. Under this form, the customer has to deposit certain goods or properties as security to the bank in order to get a loan against them. The bank cannot sell the goods or properties of the customer without prior permission from the court when the customer fails to repay the loan amount in time.

2. Pledge

It is stated in under section 172 of contract Act, 1872. "Bailement of goods on security for payment of Dept or performance of promise. Under this form when the customer fails to repay the loan amount in time, the bank can auction the securities of the customer and realize its loan amount through auction.

3. Mortgage

It is stated in under section 58 of Transfer of Property Act. Under this form, the customer deposit his property as security to the banks to get a loan against property. When the customer fails to repay the loan amount in time, then the bank has a authority to sell the property in the market an realize the loan amount.

Q26. State different types of collateral securities. Explain various precautions while advances against them.

Ans : **(Imp.)**

1. Goods

According to Lord Chorby "advances against security of goods are a usual and proper form of banking business"

Precautions in Advancing Against Goods

The banker must consider the borrower's character, borrower's experience, title of the goods, nature of goods, purpose of loan and insurance of goods. He must evaluate the goods, conduct periodical inspection of goods and undertake various other required precautions.

2. Documents of Title to Goods

Documents of title to goods are the proof of possession and control of goods. They can be transferred through delivery, endorsement and mere delivery.

Precautions in Advancing Against Documents Against Title to Goods

The banker should take into consideration the character of borrower. He should take necessary precautions before advancing the loan such as obtaining the certificate of packing, a blank endorsement on documents, trust receipt and three copies of bill of lading from the borrower. He should check whether the goods are insured against the risk of transport. He should advance the loan if he is satisfied that the documents of title to goods are clean.

3. Stock Exchange Securities

Securities refer to documents or certificates having monetary value and which can be traded in a market. They include equity securities like stocks and debts securities like debentures.

Stock exchange securities is organized market where securities are sold and purchased. The following securities are traded on the floor of stock exchange,

(i) Companies shares and debentures

(ii) Central and state government bonds

(iii) Securities such as port trusts, improvement trusts, electricity boards etc, issued by semi- government authorities.

Precautions in Advancing Against Documents Against Stock Exchange Securities

The banker must examine the securities which are selected and evaluate them. He should opt for preference shares and debentures instead of partly- paid securities. He should maintain equal margins against the securities etc.

4. Real Estates/Property

Commercial banks do not prefer to grant loan against real estates because it involve heavy risk. In case when the customer does not have any other security to offer, then only the banks accept real estate as security. As the name indicate "real estate" are immovable properties including tangible assets such as land, building etc

Precautions in Advancing Against Real Estate/Property

The banker should verify the title deeds and obtain information regarding the property. He must evaluate various details of the property including its location, right of ownership, rental value, type of construction, land size and structure. He should verify the insurance cover (if any), tax and rent payment, income tax clearance and other such details. He must maintain 50% to 60% margin of the real value of property.

5. Life Insurance Policies

The bankers may accept life insurance policies as a main security or a supplementary security. Supplementary security is very beneficial as it covers the signature by the life of the guaranter. On the other hand, in case of life insurance policy as a main security, the banker may advance 80% to 90% of its surrender value. In India life insurance policies are carried out by LIC (Life Insurance

Corporation) of India. They offer many policies such as whole life policy, joint life policy, money back policy etc. 90% of surrender value for the policies in force. 85% of surrender value for paid up policy.

Precautions in Advancing Against Life Insurance Policies

The banker must Verify and accept the endowment policy and check that there are no restrictions on assignment of policy. He should examine the age of insured and interest of insurance. He should maintain a margin of 80%-90% of the surrender value of the policy. He should not grant loan against certain policies such as policies which are under section 6 of the Married Women's Property Act.

6. **Fixed Deposit Receipts**

Bank receipts usually involve various kinds of receipts like deposit receipt, withdrawal receipts, accounts payable receipts, account receivable receipts etc. However, the most common and directly connected receipt with bank is the fixed deposit receipt. In some cases these are also referred as bank

3.12 Precautions to be taken while Advancing loans Against Goods

Q27. Write a short note on advances against goods. State the precuations to be taken by a bank while granding advance against goods.

Ans :

Advances Against Goods

According to Lord Chorby "advances against security of g (Ws are a usual and proper form of banking business". Banks provide funds against goods, thd[1,] goods can be agricultural products or manufactured goods. In India, most of the banks are providing their funds against security of goods through pledge or hypothecation.

Precautions in Advancing Against Goods

The following precautions must be taken by a bank while granting advances against goods,

1. **Borrower Character**

The bank must consider the honesty, trustworthiness and integrity of the borrower at the time of granting advances against goods.

2. **Experience of Borrower**

The bank must check whether the borrower is an experience person in a particular business or not because dealing with an inexperienced person will be a risk for the banks.

3. **Title to the Goods**

The bank must find out the borrower's genuine title to the goods through cash receipts or invoices.

4. **Nature of Goods**

The bank must also consider the nature of the goods. It should prefer only those goods which can be stored for longer period of time and easily realizable goods.

5. **Purpose of Loan**

The bank should also find out the reason why customer is taking a loan against goods. The loan is provided only for the productive purposes and for the resale of goods.

6. **Valuation of Goods**

Goods are valued with proper care and even an expert will be appointed to value the goods. He must compare the prevailing prizes and prices quoted in the bill at the time of valuation of goods.

Short Question and Answers

1. Define Negotiable Instruments.

Ans :

Negotiable instruments are the most common credit devices which are freely used in handling commercial transactions. These instruments make possible monetary dealings without using cash balances. These instruments include exchanging documents like bill of exchange, promissory notes, cheques etc. These instruments make possible replacement of currency, paper notes and coins i.e. legal tender money. These instruments create a right in favour of some persons.

A negotiable instrument is a method of transferring a debt from one person to another. The word 'negotiable' means transferable from one person to another in return for consideration and instrument means a written document by which a right is created in favour of some person. Thus, a negotiable instrument is a document which entitles a person to a sum of money and which is transferable from one person to another by endorsement and delivery.

2. Parties involved in negotiable instrument.

Ans :

i) **Drawer:** A person drawing or making a bill of exchange or cheque is known as "drawer".

ii) **Maker:** 'Maker' refers to a person who makes a promissory note.

iii) **Drawee:** According to Sec.7, para 1, "A drawee is a person on whose name bill of exchange or cheque is drawn and a person who is instructed to pay a certain sum of money, in case of a cheque, banker is a 'drawee'".

iv) **Acceptor:** In case of bill of exchange, bill is sent to drawee for acceptance. Drawee becomes acceptor after the acceptance of the bill. Drawee signs the bill which is the symbol of acceptance and sends that bill or informs the holder or any other person working on behalf of holder about the acceptance of bill. No acceptance is needed for cheque, as cheque is drawn with an intention of getting quick payment.

v) **Payee:** As per Sec.7, para 5, "A person whose name is given in a bill of exchange, promissory note or cheque and to whom or on whose demand a certain sum of money is to be paid is known as 'payee'. In case of bill of exchange or cheque, drawer may be the payee. If the payee name specified in a bill is an imaginary one then bill is considered as payable to bearer".

vi) **Drawee in Case of Need:** Apart from the name of the drawee, if any other person's name is given in a bill or endorsement for the purpose of approaching him in case of need then that person is known as "drawee in case of need". "Drawee in case of need" is also known as "referee in case of need" in English law. Drawer or endorser may give the name of drawee in case of need at the time of drawing of bill.

If the name of the drawee in case of need is specified in a bill of exchange or endorsement then the bill will not get dishonoured till the drawer in case of need dishonours it.

3. Promissory Note

Ans :

Promissory note is an unconditional document in which the drawer promise to pay the amount stated in it after a definite period or on demand to payee or on his order to the bearer. It is a written promise made by one person to pay certain sum of money due to another person or any other legal holder of the document. According to section 4 of Negotiable Instrument Act, 1881, "A promissory note is an instrument in writing containing unconditional undertaking, signed by the maker, to pay a certain sum of money to, or to the order of a certain person, or to the bearer of the instrument."

4. Bill of Exchange

Ans :

A bill of exchange, popularly known as a bill is an instrument in writing containing an unconditional order, signed by the maker directing a certain person to pay a certain sum of money only to, or to order of, a certain person of to the bearer of the instrument. It is a written document. It is an acknowledgment of a debt. The creditor prepares a bill of exchange which is accepted by the debtor.

Sec 5 of the Negotiable Instruments Act defines a bill of exchange as an instrument in writing containing an unconditional order, signed by the maker, directing a certain person to pay a certain sum of money only to or to the order of a certain person or to the bearer of the instrument.

5. Cheque

Ans :

A cheque is a mode of order to the bank by the depositor to make the stipulated payment to the person in whose favour the cheque has been issued. A cheque is an instrument in writing containing an unconditional order signed by the drawer requiring the bank (drawee) to pay on demand a certain sum of money only to or to the order of, a certain person or to the bearer of the instrument.

6. Bearer Cheque

Ans :

Generally, the cheque indicates the name of a person to whom the amount is to be paid. He is called the payee, paying bank is the drawee and the person who draws the cheques is the drawer. In case of bearer cheque, the wording of the cheque is pay to or bearer. It is not necessary for the payee to personally present the cheque and get the money. He can sign on the back and hand it over to any other person. Any person who holds the cheque lawfully can get payment. The person who presents the cheque is called the bearer. Bank is not bound to verify the identity of the bearer. Thus, any bearer cheque lost or stolen is likely to be presented for payment. There is nothing to pin joint the identity of the person who accepted payment. Anybody who comes in possession of the cheque can encash it. Thus, bearer cheques are somewhat risky.

7. Crossed Cheque

Ans :

When two parallel lines are drawn on the top left side of the cheque, it is called crossed cheque. The lines should be conspicuous. The lines may or may not contain the words '& Co'. When a cheque is crossed, the payment is not made across the counter but the amount is credited to the payee's account. He can then withdraw the amount from his account. A crossed cheque is an express instruction to the banker not to make cash payment. This is the safest type of cheque. This is called general crossing. Sometimes, name of a specific bank and branch is written between the lines. It means the cheque must be presented through that bank only. This is called special crossing. In such case, the amount is paid to the specific bank which in turn credits the amount to the payee's account. The words 'not negotiable' between the lines destroy the negotiability of the cheque.

8. Compare and contrast Promissory note and bill of exchange.

Ans :

S. No.	Points	Promissory Note	Bill of Exchange
1.	**Number of Parties**	**Two Parties** i) Drawer ii) Drawee	**Three Parties** i) Maker ii) Payee iii) Payee
2.	**Payee**	Maker of a promissory note can't be the payee.	Drawer and payee may be the same person.
3.	**Promise and Order**	It is a promise to make the payment.	It is an order for making the payment.
4.	**Acceptance**	Requires no acceptance as it is signed by the person who is liable to pay.	Must be accepted by the drawee before it can be presented for payment.
5.	**Nature of Liability**	Liability of the maker is absolute and primary.	Liability of the drawer is secondary conditional. It arises only and when acceptor dishonours the bill.
6.	**Payable to Bearer**	A promissory note can't be drawn 'payable to bearer' it is not drawn 'payable to bearer on demand.'	A bill of exchange can be so drawn provided.

9. Define paying banker.

Ans :

The banker on whom the cheque is drawn or the banker who is required to pay the cheque drawn on him by a customer is called the Payment Banker or Drawee Banker. The banker who is liable to pay the value of a cheque of a customer as per the contract, when the amount is due from him to the customer is called 'Paying Banker'. The payment to be made by the bank has arisen due to the contractual obligation. Paying Banker is also known as drawee bank as the cheque is drawn on him. The payment has to be made by the banker as per the legal obligation.

10. Define collecting banker.

Ans :

As per Section 131 of Negotiable Instrument Act 1881. "A banker who has in good faith and without negligence received payment for a customer of a cheque crossed generally or specifically to himself shall not, in case the title to the cheque proves defective, incur any liability to the true owner of the cheque by reason of only having received such payment.

11. Types of Loans and Advances

Ans :

According to the needs and requirements of customers, commercial banks provides different types of loans and advances as follows,

i) **Demand Loan:** These loans are sanctioned against goods and documents of title of goods, banks own fixed deposit, gold ornaments. These loans are for short period.

ii) **Term Loan:** A bank loan with a floating interest rate and which is repaid over a specific period of time i.e., from 1-10 years is known as term loan.

It ranges from 1 to 5 years medium term, 5 to 10 years long term.

iii) **Cash Credit:** Cash credit is one of the facility which is provided by the banker wherein, the borrower is allowed to withdraw the amount upto a particular limit. The customer's account is credited with the amount and he can make the withdrawals as per his needs. The bank usually charges interest on amount which is withdrawn and not on the complete amount which is being credited to the borrower's account. In cash credit, the banker clearly mentions a particular limit of loan for the customer, which is termed as cash credit limit. If suppose the customer maintains the account properly, then cash credit limit would be renewed by the bank at the year ending.

iv) **Overdraft:** The term 'Overdraft' refers to the act of overdrawing from bank account. In overdraft, the account holder is enabled of withdrawn amount which is usually more than the credit balance in his/her account. This facility is basically given for a shorter period of time to those customers who carry out their transactions via Cheques. Overdraft facility is usually given on security on assets or on personal security.

v) **Discounting of Bills of Exchange:** Bill discounting is another type of facility which is usually provided by discounting the general trade bills i.e., doing the payment prior to the due date of bills and after excluding a particular discount rate. On due date, bank submits the bill to the borrower's customer and collects the complete amount. In case, if the bill is dishonoured then bank collects the amount along with interest from the borrower or his customers. Bill discounting is an advance which is given for security of bill. Bank verifies the creditworthiness of drawer and genuineness of the bill before discounting it.

Choose the Correct Answer

1. __________ is special kind of bailment. [a]
   (a) Pledge (b) Agency
   (c) Contract (d) Agreement
2. A seller who has not been paid the whole price of the goods sold is known as [b]
   (a) Paid seller (b) Unpaid seller
   (c) Yet to pay seller (d) Post paid seller.
3. __________ are rules, regulations and by-laws for the internal management of the affairs of a company. [c]
   (a) Memorandum (b) Contract
   (c) Articles (d) Negotiable instruments
4. The person to whom goods are delivered under a contract of bailment is [d]
   (a) Bailer (b) Pledger
   (c) Seller (d) Bailee
5. Advances against __________ are short term in nature. [c]
   (a) Real estate (b) Life policy
   (c) Goods (d) stock
6. The person who gives the guarantee is called __________ [b]
   (a) Creditor (b) Surety
   (c) Debtor (d) Agent
7. When a cheque bears in addition of the name of a Banker then it is called as [c]
   (a) General crossing (b) Restrictive crossing
   (c) Special crossing (d) Bill of exchange
8. Promissory note have __________ parties [d]
   (a) Three (b) One
   (c) Six (d) Two
9. It is very difficult to ascertain the title in the case of [a]
   (a) Land and Building (b) Stock Exchange securities
   (c) Life policies (d) Shares of private companies
10. The finder of goods possess the following right [c]
    (a) Right to possess goods (b) Right to sue trespassers
    (c) Right to sale (d) Right to claim damages.

Fill in the Blanks

1. ________ instruments are the most common credit devices which are freely used in handling commercial transactions.
2. A person drawing or making a bill of exchange or cheque is known as ________ .
3. ________ is a person to whom the bill of exchange, promissory note or cheque is endorsed by endorser.
4. A ________ is a document that orders a payment of money from a bank account.
5. A ________ cheque is not honoured by the bank.
6. If a cheque bears a date which is yet to come (future date) then it is known as ________.
7. If a cheque bears a date earlier than the date on which it is presented to the bank, it is called as ________.
8. ________ is one of the facility which is provided by the banker wherein, the borrower is allowed to withdraw the amount upto a particular limit.
9. The term ________ refers to the act of overdrawing from bank account.
10. LIC stands for ________.

Answers

1. Negotiable
2. Drawer
3. Endorsee
4. Cheque
5. Stale
6. Post-dated cheque.
7. Antidated cheque
8. Cash credit
9. 'Overdraft'
10. Life Insurance Corporation

UNIT IV

CUSTOMER RELATIONSHIP IN BANKS:

Banker Customers Relationship, Procedure for opening account difference types of loans, advances, operation of banking cheques crossing, endorsements. Types and rules of wrong principles of sound lending.

4.1 Banker Customers Relationship

Q1. Explain briefly the special relationship between banker and customer.

(OR)

Explain briefly the general relationship between banker and customer.

(OR)

Explain the relationship between banker and customer.

Ans : **(Dec.-21, Oct.-20, May-19, Imp.)**

The relationship between a banker and customers can be broadly classified into

(A) General Relationship

(B) Special Relationship.

As per Sec 5(b) of Banking Regulation Act, the bank's business is to accept deposits for the purpose of lending. Thus, the relationship emerging out of these two main activities is called as General Relationship. As per

Sec 6 of Banking Regulation Act, the banker undertakes other activities on behalf of the customer and provides lot of services to them. Thus, the relationship emerging out of the provision of these activities and services is called as Special Relationship.

(A) General Relationship

Under general relationship, the banker and customer may have two types of relationships, viz., debtor-creditor relationship and creditor-debtor relationship.

(i) **Debtor-Creditor Relationship:** While opening a bank account, customers fill and sign the account opening form to enter into an agreement/contract with the banker. When the customers deposit money in their account, the relationship between banker and customer becomes that of debtor and creditor. The amount deposited becomes the banks' liability towards the customer and hence, he becomes debtor to the depositor (Customers). The banker can use that amount for any purpose, of course, with the information as to the use of money to the depositors. Normally, banks do not give any security to the depositors. However, when it is demanded by the deposits, the banks have to pay. Thus, the banker is completely different from normal debtors who voluntarily repay the debts. The rate of interest on the loan is normally decided by the creditor but in the banker-customer relationship the interest is decided by the banker who as a debtor pays interest once in six months on the deposits.

(ii) **Creditor Debtor:** When banks grant loans and advances to the customers, the relationship between banker and customer is that of creditor-debtor relationship. Customers borrow money from bank by executing a contract with terms and conditions and by offering collateral (security). The customers (as debtors) are obliged to repay the loans and advances as per the terms of the contract.

(iii) **Principal and Agent:** Banker acts as the agent of the customer in those cases where it performs agency functions such as collection of cheques, bills of exchange purchasing and selling securities, payment of insurance premium etc., on behalf of his customer.

(iv) Bailor and Bailee

When a bank accepts articles for safe custody, its legal position is that of bailee who is duty bound to take as much care of goods bailed to him as man of ordinary precedence would, under similar circumstances, take of his own similar goods. Section 152 of the Indian Contract Act says that the bailee, in absence of any contract to the contrary is not responsible for any loss if the bailee has taken care as required in terms of section 151 of the Act. Bailee has right of particular lien in terms of section 170 of the Indian Contract Act, which says that bank has right over goods bailed until he receives remuneration for his services rendered in respect of them, unless there is a contract to the contrary.

(v) Lessor and Lessee

On hiring out of locker, bank becomes lessor and hirer a lessee and the relationship is that of landlord and tenant. The lessor is not responsible for any loss or damage suitable clause to the effect is also incorporated in the Lease Deed and hirers are advised, in their own interest, to insure their valuables in their own interest.

(B) Special Relationship

In addition to opening of a deposit/loan account banks provide variety of services, which makes the relationship more wide and complex. Depending upon the type of services rendered and the nature of transaction, the banker acts as a bailee, trustee, principal, agent, lessor, custodian etc.

(i) Banker as a Trustee

As per Sec. 3 of Indian Trust Act, 1882 ' A "trust" is an obligation annexed to the ownership of property, and arising out of a confidence reposed in and accepted by the owner, or declared and accepted by him, for the benefit of another, or of another and the owner.' Thus trustee is the holder of property on behalf of a beneficiary. As per Sec. 15 of the 'Indian Trust Act, 1882 'A trustee is bound to deal with the trust-property as carefully as a man of ordinary prudence would deal with such property if it were his own; and, in the absence of a contract to the contrary, a trustee so dealing is not responsible for the loss, destruction or deterioration of the trust-property.' A trustee has the right to reimbursement of expenses (Sec.32 of Indian Trust Act.). In case of trust, banker-customer relationship is a special contract.

(ii) Banker as a Bailee

Sec.148 of Indian Contract Act, 1872, defines "Bailment" "bailor" and "bailee". A "bailment" is the delivery of goods by one person to another for some purpose, upon a contract that they shall, when the purpose is accomplished, be returned or otherwise disposed of according to the directions of the person delivering them. The person delivering the goods is called the "bailor". The person to whom they are delivered is called, the "bailee". Banks secure customer advances by obtaining tangible securities.

In some cases physical possession of securities goods (Pledge), valuables, bonds etc., are taken. While taking physical possession of securities, the relationship between banker and customer becomes that of bailee and bailor. Banks also keeps articles, valuables, securities etc., of its customers in Safe Custody and acts as a Bailee. As a bailee, the bank is required to take care of the goods bailed.

(iii) Banker as a Lessor

Sec.105 of 'Transfer of property Act 1882' defines lease, Lessor, lessee, premium and rent. As per the section "A lease of immovable property is a transfer of a right to enjoy such property, made for a certain time, express or implied, or in perpetuity, in consideration of a price paid or promised, or of money, a share of crops, service or any other thing of value, to be rendered periodically or on specified occasions to the transferor by the transferee, who accepts the transfer on such terms." "The transferor is called the lessor, the transferee is called the lessee, the price is called the premium, and the money, share, service or other thing to be so rendered is called the rent." Providing safe deposit lockers is as an ancillary service provided by banks to customers. While providing Safe Deposit Vault/locker facility to their customers, bank enters into an agreement with the customer. The agreement is known as "Memorandum of letting" and attracts stamp duty. The relationship between the bank and the customer is that of lessor and lessee.

(iv) Banker as an Agent

Sec.182 of 'The Indian Contract Act, 1872' defines "an agent" as a person employed to do any act for another or to represent another in dealings with third persons. The person for whom such act is done or who is so represented is called "the Principal". Thus an agent is a person, who acts for and on behalf of the principal and under the latter's express or implied authority and the acts done within such authority are binding on his principal and, the principal is liable to the party for the acts of the agent.

Banks collect cheques, bills, and makes payment to various authorities, viz., rent, telephone bills, insurance premium etc., on behalf of customers.. Banks also abides by the standing instructions given by its customers. In all such cases, bank acts as an agent of its customer, and charges for these services. As per Indian contract Act agent is entitled to charges. No charges are levied in collection of local cheques through clearing house. Charges are levied in only when the cheque is returned in the clearinghouse.

(v) Banker as a Custodian

A custodian is a person who acts as a caretaker of something. Banks take legal responsibility for a customer's securities. While opening a DMAT account bank becomes a custodian.

(vi) Banker as a Guarantor

Banks give guarantee on behalf of their customers. Guarantee is a contingent contract. As per sec 31, of Indian contract Act guarantee is a "contingent contract". Contingent contract is a contract to do or not to do something, if some event, collateral to such contract, does or does not happen. It would thus be observed that banker customer relationship is transactional relationship.

Q2. Explain the different rights of banker.

Ans :

The rights of the banker vis-à-vis customer include the following:

Right of Lien

A lien is the right of a creditor in possession of goods, securities or any other assets belonging to the debtor to retain them until the debt is repaid, provided that there is no contract express or implied, to the contrary. It is a right to retain possession of specific goods or securities or other movables of which the ownership vests in some other person and the possession can be retained till the owner discharges the debt or obligation to the possessor. The creditor (bank) has the right to maintain the security of the debtor but not to sell it. There are two types of lien viz.,

(a) Particular Lien

(b) Right of General Lien

(a) Particular Lien

A 'particular lien' gives the right to retain possession only of those goods in respect of which the dues have arisen. It is also termed as ordinary lien. If the bank has obtained a particular security for a particular debt, then the banker's right gets converted into a particular lien.

(b) Right of General Lien

Banker has a right of general lien against his borrower. General lien confers banks right in respect of all dues and not for a particular due. It is a statutory right of the bank and is available even in absence of an agreement but it does not confer the right to pledge. A 'general lien' gives the right to retain possession of any goods in the legal possession of the creditor until the whole of the debt due from the debtor is paid. Section 171 of Indian Contract Act, 1872 confers the right of general lien to banks. As per the section

"Bankers, factors, attorneys of a High Court and policy-brokers may, in the absence of a contract to the contrary, retain, as a security for a general balance of account any goods bailed to them; but no other persons have a right to retain, as a security for such balance, goods bailed to them, unless there is an express contract to the effect. "Bank has a right of lien only when goods, securities are received in the capacity as a creditor. While granting advances banks take documents.

4.2 Procedure for Opening Account

Q3. Explain the different types of accounts opened with a bank.

Ans :

A bank account is a financial account maintained by a bank for a customer. A bank account can be a"deposit account, a saving account, a credit card account, a current account or any other type of account offered by a bank. It represents the funds that a customer has entrusted to the bank and from which the customer can make withdrawals. Accounts may be loan accounts in which case the client owes money to the bank. The financial transactions which have occurred within a given period of time on a bank account are reported to the customer on a bank statement.

Types of Accounts

1. **Fixed Deposit Account:** Fixed Deposit Account is also known as Time Deposit Account. Under Fixed Deposit Account money is deposited for a fixed period and is not supposed to be withdrawn before the expiry of the pre-decided period. The fixed deposit account is opened from 15 days to five years. The rate of interest is paid on this account relatively high than any other types of accounts. The amount deposited in fixed deposit account is repayable after a fixed or specified period. It is the most suitable form of accepting deposits for a commercial bank. Commercial banks paid a higher rate of interest on fixed deposit to attract more deposits for long period. The depositors deposit their funds in such account with a view to earn maximum interest. Bank may allow the customer to withdraw a deposit before the expiry of the due date or may grant a loan against the fixed deposit. If the customer takes a loan against the deposit, he has to pay interest at a higher rate than allowed on his deposit. If the customer withdraws the money before the due date, he foregoes a part of interest accrued on such deposit.

2. **Saving Bank Deposit Account:** This account is meant for the benefit of middle class and low income group people. The customer can deposit his small savings in this type of account. A Saving Bank Deposit Account can be opened by any person with a minimum specified deposit. The important feature of this account is that deposits can be made for any number of times in a week in this account. But withdrawals can be made only once or twice in a week. Banks impose some restriction on the withdrawals to discourage the habit of frequent withdrawals. Most of the banks permit 50 withdrawals in a half year. The rate of interest payable on such deposits is very low as compared to fixed deposit accounts by the banks. Interest is allowed on the minimum balance standing to the credit of an account during the period from the tenth day of the month to the last day of every month. A Pass Book is issued to saving bank account-holder. The depositor is normally. Required to present his pass book together with a withdrawal form when he wants to withdraw money. Banks have started to allow cheque facility also to saving bank depositors who maintain a minimum balance in the account.

3. **Current Account :** Current Account is also known as 'Open Account'. In Current Account, money can be deposited and withdrawn at any time during working hours without giving any notice to the bank. Businessmen like to keep their money with a bank rather than in their own cash box from where it can be lost or stolen, because the money can be deposited or withdrawn from a current account whenever they like. Banks provide overdraft facility to the current account holder. The object of current

accounts is to provide facilities to businessmen for depositing and with drawing money whereby they are relived of the task of handling cash themselves and the risk inherent therein. This account can be freely operated by the customer. Customer can withdraw money from his account by cheque at any time during the working hours of the bank on any working day. There is no restrictions on the number of withdrawals. Banks generally do not pay interest on current accounts of deposit.

4. **Recurring Deposit Account:** A predetermined amount is deposited into account every month in a recurring deposit account. The rate of interest is normally equal to the rate of interest payable on a term deposit account of the same period.

5. **Flexible Account:** Flexible accounts combine the characteristics and benefits of savings account and fixed deposit accounts. In such accounts a fixed deposit account is opened for the maturity periods available and a savings account is also opened. The amount in fixed deposit account is treated as units of ` 1000 each. In case of customer needs money in excess of balance in the saving account, the requisite amount will be transferred out of fixed deposit account in units of ` 1000 each along with interest payable on the amount as per RBI regulations. The remaining amount in fixed deposit continues to earn at contracted rates. Some examples of flexible accounts are Quantum fixed deposits of ICICI Bank and Earn m% re-account of Deutsche Bank.

Q4. Discuss the procedure to open a bank account.

Ans : **(Imp.)**

The following procedure is followed in opening a bank account.

1. **Application Form:** The person wants to open a current account or a saving bank account has to apply to the bank concerned on the prescribed form. Printed application forms are available in the bank free of cost.

   The application form contains the various informations relating to the name of the applicant, his occupation, full address, and specimen signatures. Banks provide different application forms for opening a savings or current account.

2. **Introduction :** The bank may also ask for references and introduction who would be consulted about the integrity, honesty, financial standing and responsibility of an applicant. The bank insists on such person or business enterprise being introduced to the bank by an existing customer of the bank or a reputed businessman. Introduction and references reduce the scope for fraud and risk. Though any person may apply for opening an account in his name but the bank reserve the right to do so on being satisfied about the identity of the customer.

3. **Specimen Signatures :** When the bank is satisfied with the introductory references it proceeds with the opening of the account. The applicant is asked to give his two or three specimen signatures on a prescribed form, generally card, for the purpose of bank's record.

   These specimen signature cards are preserved by the bank and are alphabetically filed for ready reference to verify the signatures whenever the need arises. The specimen signatures are compared with the signatures on the cheques of the customer. If the two signatures differ, the bank can refuse to honour the cheque.

4. **Photographs :** Banks require four copies of photographs of the account holders. These photographs are required for all types of account opening. If a customer has a savings account or current with a bank's branch, he may open fixed deposit account without photographs. When a customer comes to a branch he can be easily identified. The identity of the customer is very clearly established with the help of photographs.

5. **Initial Deposit :** After the above formalities are fulfilled, the applicant deposits the initial amount and the banker opens an account in the name of the applicant. The minimum amount to be deposited initially differs from bank to bank.

4.3 Loans

4.3.1 Difference Types of Loans

Q5. Explain different types of Loans granted by banking sector.

(OR)

What is meant by loan? State different types of loans.

Ans : **(May-19, Imp.)**

Meaning

The term loan is popularly used to denote the granting of an advance in lump sum, usually based on some acceptable securities. Under the loan system, credit is given for a definite purpose and for a predetermined period. Traditionally loans were provided for working capital funds for business operations, but banks have extended their lending activities to investment in long-term bonds and open end securities, both government and private. Furthermore, loans are advanced not just for financing trade and industry, but also to government units as well as to consumers for a range of personal products like housing, automobiles, education, etc).

Types

Loans can broadly be categorised based on the period sanctioned or on the basis of the purpose of the loan. On basis of period, they can be short-term, medium term or long-term loan or a bridge loan. They can be composite or consumption loans depending on their purpose. A brief description follows:

1. **Short-term Loans:** Short-term loans are loans which are granted for a period not exceeding one year. These are advanced to meet the working capital requirements, again security of movable assets like goods, commodities, shares, debentures, etc. They are usually taken to meet the working capital requirements of business.

2. **Term Loans:** Medium and long-term loans are usually called term loans. These loans are extended for periods ranging from one year to about eight or ten years on the security of existing industrial assets or the assets purchased with the loan. Term loans are used for purchase of capital assets for establishment of new industrial units, for expansion, modernisation or diversification. They involve an element of risk as they are intended to be repaid out of the future profits over period of years. Consequently, apart from the financial appraisal of such loans, the technical feasibility and managerial competency of the borrower should also be studied. Banks can charge fixed rates of interest for the entire period or different prime lending rates for different maturities, provided transparency and uniformity of treatment is maintained.

3. **Bridge Loans:** Bridge loans are essentially short-term loans that are granted pending disbursement of sanctioned term loans. These help borrowers to meet their urgent and critical needs during the period when formalities for availing of the term loans sanctioned are being fulfilled. They are repaid out of the amount of such loans or from the funds raised in the capital market, if these loans are granted by financial institutions.

4. **Composite Loans:** If a loan is taken for buying capital assets as well as for meeting working capital requirements, it is called a composite loan. Usually such loans are availed by small entrepreneurs, artisans and farmers.

5. **Consumption Loans:** Traditionally, banks used to focus on loans for productive purposes, but during the recent past banks have increasingly started giving loans for consumption purposes like education, medical needs and automobiles.

4.4 Advances

4.4.1 Difference Types of Advances

Q6. Define advances. Explain the various methods of granting advances.

(OR)

What are the different types of advances?

Ans : **(May-19, Imp.)**

Meaning

Advances are the source of finance, which are provided by the banks to the companies to meet the short-term financial requirement. It is a credit facility, which should be repaid within one year as per the terms, conditions and norms issued by Reserve Bank of India for lending and also by the schemes of the concerned bank. They are granted against securities, which are as under:

- **Primary Security:** Hypothecation of Debtors, Stock Pro-notes, etc.
- **Collateral Security:** Mortgage of land and buildings, machinery, etc.
- **Guarantees:** Guarantees given by partners, directors or promoters, etc.

Methods of Granting Advances

The main methods of granting advances in India may be classified as follows:

(a) Cash Credit

Cash credit is the most favoured method for availing credit in India. Under this system the bankers fixes a cash credit limit on an annual basis, and the customer is at liberty to withdraw any amount as and when he needs. Thus, the cash credit account is an active and running account to which deposits and withdrawals may be affected frequently.

Features

1. The bank fixes the cash credit limit of the borrower after studying the financial capacity, projected sales and past utilization of such limits.
2. The borrower has to provide security of tangible assets (in the form of pledge or hypothecation) or guarantees.
3. The borrower can withdraw from this account whenever he requires and whatever amount he needs, provided the amount does not exceed the cash credit limit.
4. Interest is charged only on the actual amount withdrawn, and for the actual period for which it is utilized.
5. Even though the advances sanctioned under this system are made for the period of one year but in reality they 'roll over' a period of time. Initially a commitment charge of 1 per cent was levied on the unutilised amount, but it was withdrawn RBI has now left this upon this discretion of individual banks.

(b) Overdraft

An overdraft is a short-term credit facility. It is given to a current account holder, by which he is allowed to withdraw more money from his account then what is actually stands to his credit.

Features

1. For granting an overdraft limit, the banker may either insist on a collateral security or grant it on the personal security of the borrower.
2. The customer can withdraw as much money as is needed subject to a maximum of the overdraft limit which has been sanctioned.
3. Interest is charged on the actual amount utilised and for the period that it is utilised.
4. Sometimes in the absence of an express agreement for an overdraft facility, such an agreement can be inferred from the course of business between the banker and customer.
5. If the lending bank desires so, the overdraft facility can be discontinued or recast.

(c) Bills Discounting

Another short-term facility for providing working capital is through discounting and purchasing of bills. When the customer provides a bill of exchange as security, the banker deducts a certain amount, called discount, from the face value of the bill and advances the rest of the amount to the customer. Bills are considered as highly liquid security and, therefore, they are highly favoured especially by the conservative banks.

In addition to advancing money by discounting bills, a banker purchases them outright at face value and less bank charges. Purchase of bills is normally confined to bills payable on demand.

(d) Secured Advances

In accordance with the principles of safety and security of sound lending, commercial banks prefer to make advances against securities. A secured advance is one which is made on the security of either assets (whose market value is not at any time less than the amount of loan or advance), or against personal security (Book debts, bills receivable) or other guarantees. An advance, which is not secured, is called an unsecured advance.

The basic objective of obtaining securities is to recover the unpaid amount of loan if any, through the sale of these securities. Hence, the securities should be clearly identifiable (in physical form as well as in value terms), be easily marketable, have stability (price should not be subjected to high fluctuations), and their title should be clear and easily transferable.

Q7. Distinguish between loan and advances.

Ans :

Sl. No.	Basis for Comparison	Loan	Advances
1.	Meaning	Funds borrowed by an entity from another entity, repayable after a specific period carrying interest rate is known as Loans.	Funds provided by the bank to an entity for a specific purpose, to be repayable after a short duration is known as Advances.
2.	What is it?	Debt	Credit Facility
3.	Term	Long Term	Short Term
4.	Legal formalities	More	Less
5	Security	May or may not be secured security and guarantees.	Primary security, collateral

4.5 Operation of Banking

Q8. What are the various Operations of Banking.

Ans :

The provision of payment services involving the transfer of ownership of bank deposits from one account to another, deposit facilities and advance credit by means of overdrafts and loans by the discounting of bills and by trade finance constitute the ordinary business of banking. There has been a sea change in the business of banking in the last 40 years as exemplified by the rise of wholesale banking, liability management, international banking, multiple currency loans, rollover credits. 'securitised lending', collaterised mortgages, note issuance facilities, interest rate and currency options and financial futures, Credit cards, debit cards, automated teller machines, e-cash and online banking, are also a part of the worldwide process of change which began in 1960s and has been sustained ever since. Banks, globally, have undergone fundamental changes because of the ongoing revolution in information technology and communications.

The winds of change are reshaping the nature of banking and financial markets. The demand for new types of services as well as the need to step up earnings through fee income is the major factors. On the other hand, technological advances by reducing costs give individuals and business firms direct access to markets reducing the need for banks to offer certain services. Technological advances and subsequent innovations have also led to the creation of new markets in terms of future options and secondary mortgage markets, expanding the range of portfolio strategies open to financial intermediaries. The changes in competitive conditions since 1990s with banks as a leading partner of financial services industry have transformed banks (especially large international ones) into new financial firms. Among the important factors behind the changes in competitive conditions are the internationalisation of banking and financial markets. The opening up of financial markets, the supply of cross-border financial services and the impact of the entry of foreign commercial and investment banks are the important features of the process. Other factors are the continuous process of deregulation, partly as a consequence of the globalisation of the markets and partly as a muddle through process. The sources of change of banking industry are desegmentation of financial services industry, restructuring of banking industry, mergers and amalgamations of banks, integration of markets by exchanges, growth of financial information business and the Internet.

4.6 Cheques Crossing

Q9. Explain various types of crossing cheques.

(OR)

What are the types and rules of crossing?

Ans : **(Dec.-21, Aug.-21, Oct.-20, May-19)**

A cheque is said to be crossed when two transverse parallel lines with or without any words are drawn across its face. A crossing is a direction to the paying banker to pay the money generally to a banker or a particular banker as the case may be, and not to the holder at the counter. Crossing may be written, stamped, printed or perforated.

Object of crossing

Crossing affords security and protection to the true owner, since payment of such a cheque has to be made through a banker. It can, therefore, be easily detected to whose use the money has been received. Cheques are crossed in order to avoid losses arising from open cheques falling into the hands of wrong persons.

Crossing of a cheque does not affect its negotiability. Crossed cheques are negotiable by delivery in case they are payable to bearer and by endorsement and delivery where they are payable to order. Holder of a crossed cheque, who has no account in any bank, can obtain payment by endorsing it in favour of some person who has get an account in a bank.

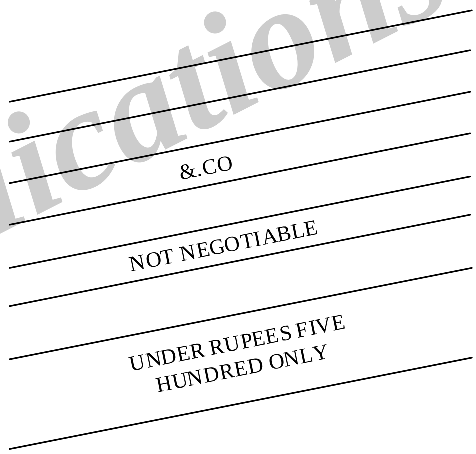
Modes of crossing

Crossing may e general, special or restrictive.

(i) General Crossing

Where a cheque bears across its face two transverse parallel lines with or without any words, it is called 'general crossing'. Words such as 'and company' or any other abbreviation, e.g., '& Co.,' may be written in between these two transverse parallel lines, either with or without words 'not negotiable' (Sec. 123). Absence of these words would not affect the validity of the crossing. In this case, the banker upon whom the cheque is drawn will make the payment only to some other banker.

SPECIMENS OF GENERAL CROSSING

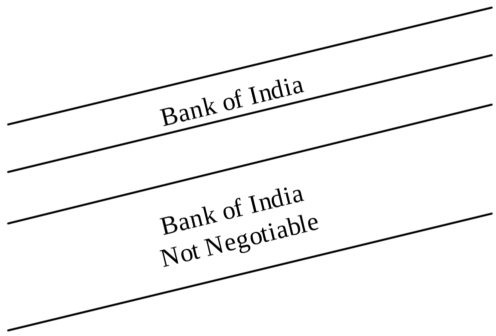


The addition of the words '&' Co.' in a crossing does not have any legal significance. But the addition of words 'not negotiable' has significant legal effect. Of course, these words do not take away the characteristics of transferability of the instrument, but they very much restrict it. This is because a transferee of a cheque bearing words 'not negotiable' will not get a better title than that of the transfer. In other words, if the transferor's title is defective the title of the holder will also be defective even if he happens to be a holder in due course.

(ii) Special Crossing

Where a cheque bears across its face an addition of the name of a banker with or without the words 'not negotiable', it shall be deemed to be a special crossing (Sec. 124). When a cheque has been specially crossed, the banker upon whom it has been drawn will make the payment only to that banker in whose favour it has been crossed.

SPECIMENS OF SPECIAL CROSSING

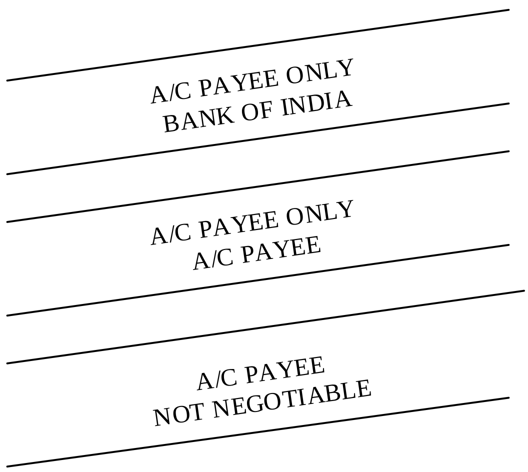


(iii) Restrictive Crossing

Besides the above two types of statutory crossing, in recent years the practice of crossing cheques with the words "account payee" or "account payee only" has sprung up. Such a crossing is termed as 'restrictive crossing'.

Restrictive crossing is only a direction to the collecting banker that the proceeds are to be credited only to the account of payee named in the cheque. In case the collecting banker allows the proceeds to be credited to some other account, it may be held liable for wrongful conversion of funds. It does not in any way affect the paying banker, who ha simply to see that the cheque has been presented to it for payment by any bank in case of general crossing and by the particular bank (named in crossing) in case of special crossing. It is under no duty to ascertain that the cheque is in fact collected for the account of the person named as payee.

SPECIMENS OF RESTRICTIVE CROSSING



It is to be noted that the basic ingredient of crossing, "the two transverse parallel lines" across the face of the cheque, must be present in order to constitute any cheque as a crossed cheque. The cheque will not be taken as a crossed cheque if this has not been done.

Q10. What are the differences between General Crossing and Special Crossing.

Ans : **(Imp.)**

General Crossing	Special Crossing
Drawing of two parallel transverse lines is a must.	Drawing of two parallel transverse lines is not essential.
Inclusion of the name of a banker is not essential.	Inclusion of the name of a banker is essential.
In General Crossing paying banker to honor the cheque from any bank A/C.	In Special Crossing paying banker to honor the cheque only when it is presented through the bank mentioned in the crossing and no other bank.
General Crossing can be converted into a Special Crossing.	Special Crossing can never be converted to General Crossing.
In case of General Crossing the words "And Company" or "& Company" or "Not Negotiable" between the transverse lines to highlight the crossing does not carry special significance.	In case of Special Crossing the name of a banker may be written within two parallel transverse lines or with the words "And Company" or "Account Payee Only" or "Not Negotiable" the inclusion of these words has become customary.

4.7 Endorsements

Q11. What is Endorsements. Explain the essentials of a valid Endorsement.

Ans : **(Imp.)**

Meaning

The process of transferring an instrument is called an endorsement. According to Section 15, when the maker or of a negotiable instrument signs the same, otherwise than as such maker, for the purpose of negotiation, on the back or face thereof or on a slip of paper annexed thereto or so signs for the same purpose a stamped paper intended to be completed as negotiable instrument, he is said to endorse the same, and is called the endorser. Thus, endorsement is signing a negotiable instrument for the purpose of negotiation.

The person making the endorsement is called an 'endorser' and the person to whom the instrument is endorsed is called an 'endorsee'.

Essentials

Essential requirements of a valid endorsement are as follows:

1. It must be on the instrument. The endorsement may be on the back or face of the instrument and if no space is left on the instrument, it may be made on a separate paper attached to it called allonage. It should usually be in ink.
2. It must be made by the maker or holder of the instrument. A stranger cannot endorse it.
3. It must be signed by the endorser. Full name is not essential. Initials may suffice. Thumb-impression should be attested. Signature may be made on any part of the instrument.
4. It may be made either by the endorser merely signing his name on the instrument (it is a black endorsement) or by any word showing an intention to endorse or transfer the instrument to a specified person (it is a blank endorsement) or by any words showing an intention to endorse or

transfer the instrument to a specified person (it is an endorsement in full). No specific form of words is prescribed for an endorsement. But intention to transfer must be present.

5. It must be completed by delivery of the instrument. The delivery must be made by the endorser himself or by somebody on his behalf with the intention of passing property therein. Thus where a person endorses an instrument to another and keeps it in his papers where it is found after his death and then delivered to the endorsee, the latter gets no right on the instrument.

6. If delivery is conditional endorsement is not complete until the condition is fulfilled.

7. It must be an endorsement of the entire bill. A partial endorsement, i.e., which puroorts to transfer to the endorsee a part only of the amount payable does not operate as a valid endorsement.

4.7.1 Types of Endorsements

Q12. Explain the different types of Endorsement.

Ans :

An endorsement may be of the following kinds:

1. Blank or General Endorsement [Section 16(1)]

A blank or general endorsement is one in which the endorser simply puts down his signature. The effect of such an endorsement is to make the cheque a bearer cheque. The property in the cheque can now be transferred by mere delivery, no endorsement being required. Thus, an order cheque can be made a bearer cheque by putting down a blank endorsement.

2. Full or Special Endorsement [Section 16(1)]

If an endorser signs his name and adds a direction to pay the amount mentioned in the instrument to, or to the order of, a specified person, the endorsement is said to be in full. Thus, an endorsement 'Pay Ram or order', 'Pay to Ram' followed in both the cases by the signature of the endorser is an endorsement in full.

3. Partial Endorsement [Section 56]

When an endorsement purports to transfer to the endorsee a part only of the amount of the instrument, the endorsement is said to be partial. A partial endorsement does not operate as a negotiation of the instrument.

4. Restrictive Endorsement

An endorsement is said to be restrictive when it prohibits or restricts the further negotiability of the instrument. It merely entitles the holder of the instrument to receive the amount on the instrument for a specific purpose.

The endorser may, by express words, restrict or exclude the right of further negotiation or may merely constitute the endorsee an agent to endorse the instrument, or to receive its contents for the endorser or for some other specified person [Section 50].

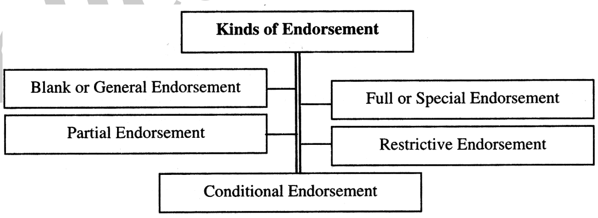


Fig. : Kinds of Endorsement

5. Conditional Endorsement [Section 52]

This endorsement limits or negatives the liability of the endorser. It differs from restrictive endorsement, which restricts the negotiability of the instrument but does not in any way limit or negative the liability of the endorser. A conditional endorsement may be in any of the following forms:

i) "Sans recourse"

In this case, the endorser expressly excludes his own liability for dishonour of the instrument towards the endorsee or any subsequent holder. This he does by writing the words "sans recourse or without recourse to me" after the name of the endorsee. Endorsee may refuse to take an instrument with such an endorsement.

ii) Facultative

If the endorser, by express words increases his liability or gives up some of his rights under the negotiable instrument, the endorsement is termed as facultative.

iii) "Sans frais"

Where the endorser does not want the endorser or any subsequent holder of the instrument, to incur any expense on his account on the instrument, the endorsement is 'sansfrais'.

iv) Liability Dependent upon a Contingency

The endorser may make the endorsement in such a way that his liability depends upon happening of a specified event, which may never happen. In case the event becomes impossible to happen, the liability of the endorsee will be at an end.

4.7.2 Rules

Q13. Explain the rules of endorsements.

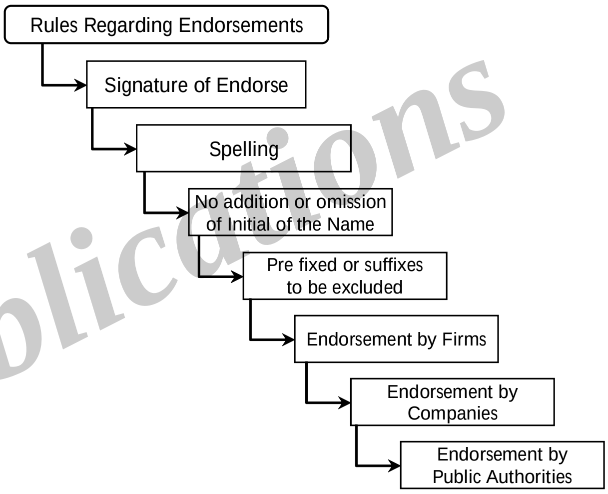
Ans : **(Imp.)**

An endorsement must be regular and valid in order to the effective. The appropriateness or otherwise of a particular form of endorsement depends upon the practice amongst the bankers. The following rules are usually followed in this regard:

1. **Signature of Endorser** : The signature on the document for the purpose of endorsement must be that of the endorser or any other person who is duly authorized to endorse on his behalf. If a cheque is payable to two persons, both of them should sign their names in their own hand-writing. If the endorser signs in block letters, it will not be considered a regular endorsement.

2. **Spelling** : The endorser should spell his name in the same way as his name appears on the cheque or the bill as its payee or endorsee. If his name is mis-spelt or his designation has been given incorrectly, he should sign the instrument in the same manner as given in the instrument. Therefore he may also put his proper signature, if he likes to do so"

No Addition or Omission of Initial of the Name : An initial of name should neither be added or omitted from the name of the payee or endorsee as given in the cheque. For example, a cheque payable to K.S. Mehta should not be endosed as K. Mehta or vice-versa. Similarly, a cheque payable to Kamail Singh Mehta should not be endorsed as K.S. Mehta.



4. **Prefixes and Suffixes to be Excluded** : The prefixes and suffixes to the names of the payee or endorsee need not be included in the endorsement. For example, the words "Mr., Messrs, Mrs., Miss, Shri, Shrimati, Lala, Babu, Dr., Major etc." need not be given by the endorser otherwise the endorsement will not be regular. However an endorser may indicate his little or rank etc., after his signature.

5. **Endorsement by Firms** : Endorsement in the case of firms can be either in the name of the firm itself, or, it may be by an authorised agent, or by a legally authorised person on behalf of the firm. The name of the firm must be mentioned in full.

6. **Endorsement by Companies** : A bill of exchange hundi or promissory note shall be

deemed to have been made, drawn, accepted or endorsed on behalf of a company, if made, drawn, accepted or endorsed in the name of or by or on behalf or an account of the company, by any person under its authority expressed or implied. Hence, the endorsement in the case of companies consists of the signature of the authorised person, followed by the rubber stamp impress on of his designatioon and also the company.

7. **Endorsement by Public Authorities** : A cheque payable to a public authority may be endorsed by officer in charge, for and on behalf of the respective body.

4.8 Principles of Sound Lending

Q14. Define lending. Explain the significance of lending.

Ans :

Meaning

Lending or advancing loans is one of the two basic functions of the commercial banks. Lending is one of the principal services provided by the bank. If accepting deposits is the function of one hand, lending is the function of the other hand. Lending is the profit or revenue earning process of the commercial bank. The process of earning profit does not start for the banks without lending. A major part of bank deposits gets blocked in cash reserves and liquid assets to meet CRR (cash reserve ratio) and SLR (Statutory liquidity ratio) requirements. The residual funds have to be used very carefully for lending to earn reasonable return.

Significance

The main profit making activity of commercial banks is advancing loans to its customer. The primary objective of loan management is to earn income by serving the credit needs of the community. A commercial bank generates near about 65 to 70 percent of its income through the lending activity. The success of a bank is heavily dependent on its lending programmes. Some of the important contributions of loans and advances to economy are as follows :

1. **Agents of Indirect Production** : Bank loans are called the agent of indirect production. The producers purchase raw materials, machinery, hire labour and other means of production through these loans advanced by the bank.

2. **Generates Employment** : Commercial banks have increased employment opportunities through their lending functions have contributed to mass production, mass distribution and mass consumption.

3. **Improvement in Standard of Living** : Bank loans and advances may be used to increase production and employment. This will result in higher income and improve the living standard of the people.

4. **Contribution to Economic Development:** The loans advanced by the banks promote the economic development of the country. Bank lending contributes to develop infrastructural facilities to promote production, distribution and boosts exports and imports.

5. **Raise the Level of Consumption :** Banks also increase the level of consumption through their consumer loans. Banks provide consumer loans for creating constant demand for consumer goods like houses, furniture, appliances, fixtures etc. in addition to the financing of agricultural, commercial and industrial activities.

6. **Source of Bank's Profit:** Banking lending also plays an important role in the gross earnings and net profits; of commercial banks. It is the most profitable as well as risky function performed by commercial banks. Therefore, it must be done efficiently, profitably and safely.

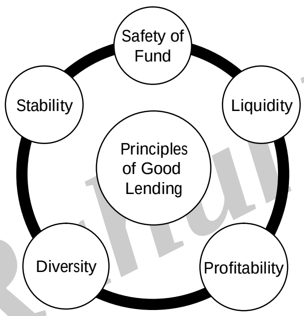
Q15. Briefly describe the principles of sound lending.

Ans : **(Oct.-20)**

The important principles of geoalending are as under :

1. **Principle of Safety of Funds:** Safety of funds is the most important principle of lending. It means that loans given by bank to the borrower must be safe. The borrower should be able to repay the principle amount alongwith interest thereon as per terms and

conditions of the agreement. It requires that it should be granted to a reliable borrower who can repay from reasonably sure sources. As lending involves risk with the public money, hence it should be done very carefully. The efficiency of a bank depends upon how efficiently it meets its commitments to the people. If the borrowers do not return loan, the bank will be unable to repay deposits and lose public confidence. Bank can never afford to loose public money nor public confidence, that is why the bank always insists upon collaterals, security and guarantees in addition to personal sureties. Sometimes the bank follows aggressive policy of lending in a bid to increase earnings. In such circumstances Banks have to be defensive ensuring that they do not loose the amount lent. They can take only calculated risks. The bank must examine loan proposals very thoroughly and check the ability of borrower to repay the loan amount. It must maintain contact with borrower after lending and remind him of his liability when it is due.



2. **Principle of Liquidity :** Liquidity of capital is another principle of good lending. The bank loans should be liquid. Liquidity refers to the readiness with which bank can convert its assets into cash with no or nominal loss. A loan will be liquid, if it has been given for a short period. Liquidity ensures smooth functioning of the bank. The major part of bank deposits is payable either on demand or an short notice. It requires liquidity. Long term lending cannot be done out of short term deposits and if done, it can prove to be fatal. For providing more liquidity, the loans should be given against security of highly shiftable assets. In case the borrower fails to repay the principle amount, the asset could be converted into cash. Liquidity is also important to the bank for borrowing from the Reserve Bank of India. Cost of borrowing from RBI depends upon net liquidity ratio. The net liquidity ratio is the ratio of net liquid assets of the borrowing bank to its aggregate demand and time liabilities. The RBI specifies net liquidity ratio for bank to obtain loan from it at bank rate. If the liquidity ratio falls below the prescribed limit the rate charged by RBI will increase proportionately.

3. **Principle of Profitability :** Profitability is another principle of sound lending. Bank must generate sufficient profit to pay interest on deposits, to meet expenses, to make provision for growth, to pay dividends to owners etc. The excess of income by way of lending over cost of borrowing is called gross profit of the bank. The bank charges different rate of interest from different borrowers depending upon the type of loan, risk involved and nature of security. The profit may be high when the risk is more. But the bank must not accept any loan proposal at the cost of liquidity and safety of the money. It must be remembered that lending rates are affected by bank rate, interbanking agreements and interbank competitions.

4. **Principle of Diversity :** Commercial bank should follow the principle of diversity in selecting its investment portfolio. Bank should not invest its surplus funds in a specific kind of security but in different types of securities. It should choose the shares and debentures of different types of industries located in different areas of the country. Diversification aims at minimizing risk of the investment portfolio of a bank. Bank should spread its risks by granting advances to different firms, industries, businesses and trades in different part of the country.

5. **Principle of Stability :** Another significant principle of a bank's investment policy should be to invest in those stocks and securities which possess a high degree of stability in their prices. The bank cannot afford any loss on the value of its securities. Hence, it should invest its funds in the share of reputed companies. Bank investments in debentures and bonds are more stable than in the shares of companies.

Short Question and Answers

1. State different types of loans.

Ans :

A brief description follows:

i) **Short-term Loans:** Short-term loans are loans which are granted for a period not exceeding one year. These are advanced to meet the working capital requirements, again security of movable assets like goods, commodities, shares, debentures, etc. They are usually taken to meet the working capital requirements of business.

ii) **Term Loans:** Medium and long-term loans are usually called term loans. These loans are extended for periods ranging from one year to about eight or ten years on the security of existing industrial assets or the assets purchased with the loan. Term loans are used for purchase of capital assets for establishment of new industrial units, for expansion, modernisation or diversification. They involve an element of risk as they are intended to be repaid out of the future profits over period of years. Consequently, apart from the financial appraisal of such loans, the technical feasibility and managerial competency of the borrower should also be studied. Banks can charge fixed rates of interest for the entire period or different prime lending rates for different maturities, provided transparency and uniformity of treatment is maintained.

iii) **Bridge Loans:** Bridge loans are essentially short-term loans that are granted pending disbursement of sanctioned term loans. These help borrowers to meet their urgent and critical needs during the period when formalities for availing of the term loans sanctioned are being fulfilled. They are repaid out of the amount of such loans or from the funds raised in the capital market, if these loans are granted by financial institutions.

iv) **Composite Loans:** If a loan is taken for buying capital assets as well as for meeting working capital requirements, it is called a composite loan. Usually such loans are availed by small entrepreneurs, artisans and farmers.

v) **Consumption Loans:** Traditionally, banks used to focus on loans for productive purposes, but during the recent past banks have increasingly started giving loans for consumption purposes like education, medical needs and automobiles.

2. Different types of advances?

Ans :

The main methods of granting advances in India may be classified as follows:

(a) **Cash Credit:** Cash credit is the most favoured method for availing credit in India. Under this system the bankers fixes a cash credit limit on an annual basis, and the customer is at liberty to withdraw any amount as and when he needs. Thus, the cash credit account is an active and running account to which deposits and withdrawals may be affected frequently.

(b) **Overdraft:** An overdraft is a short-term credit facility. It is given to a current account holder, by which he is allowed to withdraw more money from his account then what is actually stands to his credit.

(c) **Bills Discounting:** Another short-term facility for providing working capital is through discounting and purchasing of bills. When the customer provides a bill of exchange as security, the banker deducts a certain amount, called discount, from the face value of the bill and advances the rest of the amount to the customer. Bills are considered as highly liquid security and, therefore, they are highly favoured especially by the conservative banks.

In addition to advancing money by discounting bills, a banker purchases them outright at face value and less bank charges. Purchase of bills is normally confined to bills payable on demand.

(d) Secured Advances: In accordance with the principles of safety and security of sound lending, commercial banks prefer to make advances against securities. A secured advance is one which is made on the security of either assets (whose market value is not at any time less than the amount of loan or advance), or against personal security (Book debts, bills receivable) or other guarantees. An advance, which is not secured, is calleu an unsecured advance.

3. General relationship between banker and customer.

Ans :

Under general relationship, the banker and customer may have two types of relationships, viz., debtor-creditor relationship and creditor-debtor relationship.

(i) Debtor-Creditor Relationship: While opening a bank account, customers fill and sign the account opening form to enter into an agreement/contract with the banker. When the customers deposit money in their account, the relationship between banker and customer becomes that of debtor and creditor. The amount deposited becomes the banks' liability towards the customer and hence, he becomes debtor to the depositor (Customers). The banker can use that amount for any purpose, of course, with the information as to the use of money to the depositors. Normally, banks do not give any security to the depositors. However, when it is demanded by the deposits, the banks have to pay. Thus, the banker is completely different from normal debtors who voluntarily repay the debts. The rate of interest on the loan is normally decided by the creditor but in the banker-customer relationship the interest is decided by the banker who as a debtor pays interest once in six months on the deposits.

(ii) Creditor Debtor: When banks grant loans and advances to the customers, the relationship between banker and customer is that of creditor-debtor relationship. Customers borrow money from bank by executing a contract with terms and conditions and by offering collateral (security). The customers (as debtors) are obliged to repay the loans and advances as per the terms of the contract.

(iii) Principal and Agent: Banker acts as the agent of the customer in those cases where it performs agency functions such as collection of cheques, bills of exchange purchasing and selling securities, payment of insurance premium etc., on behalf of his customer.

(iv) Bailor and Bailee

When a bank accepts articles for safe custody, its legal position is that of bailee who is duty bound to take as much care of goods bailed to him as man of ordinary precedence would, under similar circumstances, take of his own similar goods. Section 152 of the Indian Contract Act says that the bailee, in absence of any contract to the contrary is not responsible for any loss if the bailee has taken care as required in terms of section 151 of the Act. Bailee has right of particular lien in terms of section 170 of the Indian Contract Act, which says that bank has right over goods bailed until he receives remuneration for his services rendered in respect of them, unless there is a contract to the contrary.

(v) Lessor and Lessee

On hiring out of locker, bank becomes lessor and hirer a lessee and the relationship is that of landlord and tenant. The lessor is not responsible for any loss or damage suitable clause to the effect is also incorporated in the Lease Deed and hirers are advised, in their own interest, to insure their valuables in their own interest.

4. Special relationship between banker and customer.

Ans :

In addition to opening of a deposit/loan account banks provide variety of services, which makes the relationship more wide and complex. Depending upon the type of services rendered and the nature of transaction, the banker acts as a bailee, trustee, principal, agent, lessor, custodian etc.

(i) Banker as a Trustee: As per Sec. 3 of Indian Trust Act, 1882 ' A "trust" is an obligation annexed to the ownership of property, and arising out of a confidence reposed in and accepted by the owner, or declared and accepted by him, for the benefit of another, or of another and the owner.' Thus trustee is the holder of property on behalf of a beneficiary. As per Sec. 15 of the 'Indian Trust Act, 1882 'A trustee is bound to deal with the trust-property as carefully as a man of ordinary prudence would deal with such property if it were his own; and, in the absence of a contract to the contrary, a trustee so dealing is not responsible for the loss, destruction or deterioration of the trust-property.' A trustee has the right to reimbursement of expenses (Sec.32 of Indian Trust Act.). In case of trust, banker-customer relationship is a special contract.

(ii) Banker as a Bailee: Sec.148 of Indian Contract Act, 1872, defines "Bailment" "bailor" and "bailee". A "bailment" is the delivery of goods by one person to another for some purpose, upon a contract that they shall, when the purpose is accomplished, be returned or otherwise disposed of according to the directions of the person delivering them. The person delivering the goods is called the "bailor". The person to whom they are delivered is called, the "bailee". Banks secure customer advances by obtaining tangible securities.

In some cases physical possession of securities goods (Pledge), valuables, bonds etc., are taken. While taking physical possession of securities, the relationship between banker and customer becomes that of bailee and bailor. Banks also keeps articles, valuables, securities etc., of its customers in Safe Custody and acts as a Bailee. As a bailee, the bank is required to take care of the goods bailed.

(iii) Banker as a Lessor: Sec.105 of 'Transfer of property Act 1882' defines lease, Lessor, lessee, premium and rent. As per the section "A lease of immovable property is a transfer of a right to enjoy such property, made for a certain time, express or implied, or in perpetuity, in consideration of a price paid or promised, or of money, a share of crops, service or any other thing of value, to be rendered periodically or on specified occasions to the transferor by the transferee, who accepts the transfer on such terms." "The transferor is called the lessor, the transferee is called the lessee, the price is called the premium, and the money, share, service or other thing to be so rendered is called the rent." Providing safe deposit lockers is as an ancillary service provided by banks to customers. While providing Safe Deposit Vault/locker facility to their customers, bank enters into an agreement with the customer. The agreement is known as "Memorandum of letting" and attracts stamp duty. The relationship between the bank and the customer is that of lessor and lessee.

(iv) Banker as an Agent: Sec.182 of 'The Indian Contract Act, 1872' defines "an agent" as a person employed to do any act for another or to represent another in dealings with third persons. The person for whom such act is done or who is so represented is called "the Principal". Thus an agent is a person, who acts for and on behalf of the principal and under the latter's express or implied authority and the acts done within such authority are binding on his principal and, the principal is liable to the party for the acts of the agent.

5. Particular Lien

Ans :

A 'particular lien' gives the right to retain possession only of those goods in respect of which the dues have arisen. It is also termed as ordinary lien. If the bank has obtained a particular security for a particular debt, then the banker's right gets converted into a particular lien.

6. Right of General Lien

Ans :

Banker has a right of general lien against his borrower. General lien confers banks right in respect of all dues and not for a particular due. It is a statutory right of the bank and is available even in absence of an agreement but it does not confer the right to pledge. A ‘general lien’ gives the right to retain possession of any goods in the legal possession of the creditor until the whole of the debt due from the debtor is paid. Section 171 of Indian Contract Act, 1872 confers the right of general lien to banks. As per the section “Bankers, factors, attorneys of a High Court and policy-brokers may, in the absence of a contract to the contrary, retain, as a security for a general balance of account any goods bailed to them; but no other persons have a right to retain, as a security for such balance, goods bailed to them, unless there is an express contract to the effect. ”Bank has a right of lien only when goods, securities are received in the capacity as a creditor. While granting advances banks take documents.

7. Distinguish between loan and advances.

Ans :

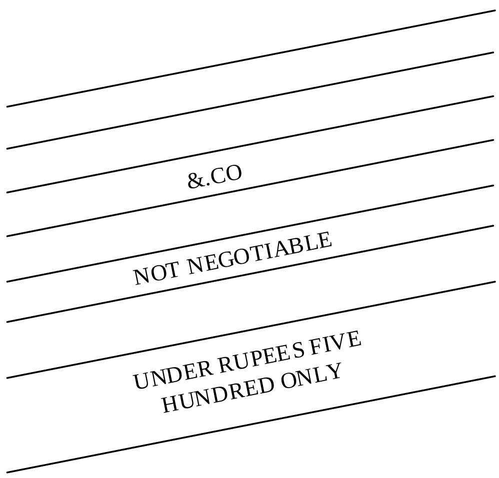
Sl.No.	Basis for Comparison	Loan	Advances
1.	Meaning	Funds borrowed by an entity from another entity, repayable after a specific period carrying interest rate is known as Loans.	Funds provided by the bank to an entity for a specific purpose, to be repayable after a short duration is known as Advances.
2.	What is it?	Debt	Credit Facility
3.	Term	Long Term	Short Term
4.	Legal formalities	More	Less

8. General Crossing

Ans :

Where a cheque bears across its face two transverse parallel lines with or without any words, it is called ‘general crossing’. Words such as ‘and company’ or any other abbreviation, e.g., ‘& Co.,’ may be written in between these two transverse parallel lines, either with or without words ‘not negotiable’ (Sec. 123). Absence of these words would not affect the validity of the crossing. In this case, the banker upon whom the cheque is drawn will make the payment only to some other banker.

SPECIMENS OF GENERAL CROSSING



The addition of the words '&' Co.' in a crossing does not have any legal significance. But the addition of words 'not negotiable' has significant legal effect. Of course, these words do not take away the characteristics of transferability of the instrument, but they very much restrict it. This is because a transferee of a cheque bearing words 'not negotiable' will not get a better title than that of the transfer. In other words, if the transferor's title is defective the title of the holder will also be defective even if he happens to be a holder in due course.

9. Special Crossing

Ans :

Where a cheque bears across its face an addition of the name of a banker with or without the words 'not negotiable', it shall be deemed to be a special crossing (Sec. 124). When a cheque has been specially crossed, the banker upon whom it has been drawn will make the payment only to that banker in whose favour it has been crossed.

10. Restrictive Crossing

Ans :

Besides the above two types of statutory crossing, in recent years the practice of crossing cheques with the words "account payee" or "account payee only" has sprung up. Such a crossing is termed as 'restrictive crossing'.

Restrictive crossing is only a direction to the collecting banker that the proceeds are to be credited only to the account of payee named in the cheque. In case the collecting banker allows the proceeds to be credited to some other account, it may be held liable for wrongful conversion of funds. It does not in any way affect the paying banker, who ha simply to see that the cheque has been presented to it for payment by any bank in case of general crossing and by the particular bank (named in crossing) in case of special crossing. It is under no duty to ascertain that the cheque is in fact collected for the account of the person named as payee.

11. What is Endorsements.

Ans : **(Imp.)**

The process of transferring an instrument is called an endorsement. According to Section 15, when the maker or of a negotiable instrument signs the same, otherwise than as such maker, for the purpose of negotiation, on the back or face thereof or on a slip of paper annexed thereto or so signs for the same purpose a stamped paper intended to be completed as negotiable instrument, he is said to endorse the same, and is called the endorser. Thus, endorsement is signing a negotiable instrument for the purpose of negotiation.

The person making the endorsement is called an 'endorser' and the person to whom the instrument is endorsed is called an 'endorsee'.

12. Different types of Endorsement.

Ans :

An endorsement may be of the following kinds:

1. Blank or General Endorsement [Section 16(1)]

A blank or general endorsement is one in which the endorser simply puts down his signature. The effect of such an endorsement is to make the cheque a bearer cheque. The property in the cheque can now be transferred by mere delivery, no endorsement being required. Thus, an order cheque can be made a bearer cheque by putting down a blank endorsement.

2. Full or Special Endorsement [Section 16(1)]

If an endorser signs his name and adds a direction to pay the amount mentioned in the instrument to, or to the order of, a specified person, the endorsement is said to be in full. Thus, an endorsement 'Pay Ram or order', 'Pay to Ram' followed in both the cases by the signature of the endorser is an endorsement in full.

3. Partial Endorsement [Section 56]

When an endorsement purports to transfer to the endorsee a part only of the amount of the instrument, the endorsement is said to be partial. A partial endorsement does not operate as a negotiation of the instrument.

4. Restrictive Endorsement

An endorsement is said to be restrictive when it prohibits or restricts the further negotiability of the instrument. It merely entitles the holder of the instrument to receive the amount on the instrument for a specific purpose.

The endorser may, by express words, restrict or exclude the right of further negotiation or may merely constitute the endorsee an agent to endorse the instrument, or to receive its contents for the endorser or for some other specified person [Section 50].

Q13. Define lending. Explain the significane of lending.

Ans :

Lending or advancing loans is one of the two basic functions of the commercial banks. Lending is one of the principal services provided by the bank. If accepting deposits is the function of one hand, lending is the function of the other hand. Lending is the profit or revenue earning process of the commercial bank. The process of earning profit does not start for the banks without lending. A major part of bank deposits gets blocked in cash reserves and liquid assets to meet CRR (cash reserve ratio) and SLR (Statutory liquidity ratio) requirements. The residual funds have to be used very carefully for lending to earn reasonable return.

Q14. Rules of crossing.

Ans :

Rules of Crossing of Cheques

A cheque can be crossed generally or may be crossed specially by the holder.

Rules for General Crossing of Cheques

The rules related to general crossing are as follows,

(i) As per section 123 of Negotiable Instrument Act, 1881, the line drawn on a cheque must be drawn parallel and transverse.

(ii) These two parallel transverse lines which may or may not include the words 'not negotiable'.

(iii) The lines are generally drawn on the left hand side of the cheque so as not to alter the printed number of the cheque.

Choose the Correct Answer

1. What is the relationship of a banker & customer in case of goods left by the customer by mistake in the bank [d]
   (a) Bailee-bailor (b) Lessor-lessee
   (c) Creditor-debtor (d) Trustee-beneficiary
2. The banker customer relationship in case of safe custody of goods is that of … [a]
   (a) Bailee-bailor (b) Trustee-beneficiary
   (c) Agent-Principal (d) Lessor-lessee
3. The word Customer is defined in [a]
   (a) KYCguidelinesissuedbyRBI (b) BCSBI
   (c) IBA (d) Banking Regulation Act
4. There is a current account in the name of a trust. The nomination in this account can be allowed if the nominee is a: [d]
   (a) Trustee (b) Person named in the trust deed
   (c) Manager (d) Nominee cannot allowed
5. What happens if a crossed cheque is presented for payment? [a]
   (a) It can be paid only through a banker
   (b) It cannot be paid at all
   (c) It can be paid across the counter in another bank
   (d) None of the above
6. Under which sector will banking sector fall? [c]
   (a) Agricultural sector (b) Industrial sector
   (c) Service sector (d) None of the above
7. What does crossing of cheques make them? [b]
   (a) Invalid document
   (b) Ineligible to endorse to a person other than the payee
   (c) Remain the same
   (d) Ineligible to get cash across the bank counter
8. What happens when a bank dishonours a cheque? [d]
   (a) It is called settlement of the cheque
   (b) It is called withdrawing of the cheque
   (c) It is called nullifying of the cheque
   (d) It is called return of the cheque unpaid

9. What happens if a cheque is post dated? [a]

(a) Bank on whom it is drawn will not honour the cheque before the date of the cheque

(b) Bank on whom it is drawn has to honour the cheque before the date of the cheque

(c) Bank on whom it is drawn has to refer to RBI to honour the cheque before the date of the cheque

(d) Bank on whom it is drawn has to refer to court to honour the cheque before the date of the cheque

10. Which one of the following is controlled by the world wide web? [b]

(a) Universal banking (b) Virtual Banking

(c) Wholesale Banking (d) None of these

Fill in the blanks

1. Banker acts as the agent of the __________ in those cases where it performs agency functions.
2. A __________ gives the right to retain possession only of those goods in respect of which the dues have arisen.
3. Banker has a right of __________ against his borrower.
4. A __________ is a person who acts as a caretaker of something.
5. The term __________ is popularly used to denote the granting of an advance in lump sum, usually based on some acceptable securities.
6. __________ if a loan is taken for buying capital assets as well as for meeting working capital requirements.
7. __________ are the source of finance, which are provided by the banks to the companies to meet the short-term financial requirement.
8. The customer who draws the cheque on the bank is called __________.
9. The first 6 numbers of cheque signify the __________.
10. A cheque is said to be __________ when two transverse parallel lines with or without any words are drawn across its face.

ANSWERS

1. Customer
2. Particular lien
3. General lien
4. Custodian
5. Loan
6. Composite Loans
7. Advances
8. Capital Drawer
9. Cheque Number
10. Crossed

UNIT V	**REGULATION AND INNOVATON IN BANKING SYSTEM :** Commercial Bank, credit allocation policies, Types of banks, Branch banking, Unit banking, Group banking, RRB, Co operative banks, micro, NABARD, IDBI. Latest trends in banking ATM, E-banking, mobile banking, E-payment, credit card, online banking, plastic money, electronic purse, digital cash, EFT, ECS (Electronic Clearing System), Safeguard for Internet Banking, comparison of traditional banking and E-banking. MSME'S, role of foreign banks, advantages & disadvantages of foreign banks.

5.1 Credit Allocation Policies

Q1. Define Credit Allocation. Explain the factors influencing Credit Allocation.

Ans :

Meaning

The credit which a bank offers for specific sector of the economy such as small business, farming, services, residential real estate, women entrepreneurs and so on is known as credit allocation. Governments usually encourage banks to extend credit to significant sectors of the economy by offering special subsidies. It allows banks to service credit needs of such sectors without impacting their competitiveness or profitability.

Factors

1. Portfolio Consideration

Portfolio considerations have a very important influence on the credit allocation policy of a bank. Portfolio management is the appropriate distributions of assets and liabilities of a bank in the light of its basic objectives. According to portfolio management, the assets of the bank must be so allocated that all the three main objectives liquidity, solvency and profitability can be achieved. The portfolio management of a commercial bank is concerned with the employment or distribution of funds in various assets in such a way that it maximises its profit without jeopardizing liquidity and solvency. The Bank management must consider the objectives of liquidity, solvency and profitability while drafting its loan policy.

2. Capital Position of the Bank

The capital position of a bank will determine and influence the credit allocation policy of a bank. Capital provides cushion for absorbing losses. A bank with a strong capital structure can afford to take more risk than a bank with a weak capital structure. Bank with strong capital structure shall be more liberal in lending. Banks with a relatively large capital structure can make loans for longer maturities.

3. Monetary Policy

The monetary policy of the central bank of the country also determines the credit allocation policy of a commercial bank. The Central Bank can influence the credit allocation policy of bank by affecting changes in the minimum reserve requirements and net liquidity ratio. An increase in net liquidity ratio and minimum cash reserve requirements would restrict the lending policy of the commercial bank. So the credit allocation policy of a commercial bank is related to the monetary policy of the central bank of the country. The availability of deployable funds depends upon the monetary policy.

7. Economic Conditions

The economic conditions prevailing in the country should also be considered while framing or formulating the credit allocation policy of a bank. An economy subject to seasonal and cyclical fluctuations cannot adopt liberal policy whereas in a stable economy the fluctuations in the level of deposits and loan demand are limited, and the banks can afford a liberal policy of lending.

8. Availability of Human Resources

Human factors play an important role in framing and execution of credit allocation policies of a bank. A bank equipped with efficient staff having expertise knowledge and experience can afford to provide different types of lending policies. Lack of expert knowledge will restrict lending of the bank. A bank who is not well equipped with skilled personnel will restrict its lending to short term loans and abstain from term loans. Therefore, the credit allocation policy will depend upon the expertise and ability of its credit officers.

9. Terms and Conditions

The banks usually compete with each other regarding terms and conditions of advancing loans. The competitive spirit will also influence the loan policy. The terms and conditions should aim at strengthening mutual relationship and confidence. The terms and conditions will also be influenced by the cost of funds.

Q2. Describe the process of credit allocation.

Ans :

The process of grant of credit includes the following steps:

1. Application Form

The borrower has to apply for a loan through prescribed application form available with the bank. The application form may be divided into two parts for the convenience of borrowers:

(i) application form to be filled in and signed by the borrower containing important information of simple nature relating to himself and his credit requirements; and

(ii) interview form in which additional information obtained by questioning the applicant and perusing his banks of account and other relevant papers may be recorded by the officer of the bank.

The application form may be common for all types of advances whereas interview form may be of different types for different types of borrowers such as small scale industries, agriculturists, transport operators service unit owners, retail traders, etc.

2. Credit Reports

Banks ascertain the creditworthiness of borrowers from time to time and maintain a credit reports on them, because advancing loans involves a great risk of bad debts if proper care is not taken. But in recent years, the work of maintaining credit reports on each and every borrower has become laborious and costly due to large increase in the number of borrowers.

The banking commission has made the following suggestions to reduce this work to some extent:

(i) The risk involved in advances granted against readily realisable securities with adequate margins is negligible and therefore, detailed credit reports on borrowers who have been sanctioned the following types of advances need not be maintained :

(a) Advances against deposits with the bank and surrender value of life insurance policies;

(b) Advances against Government and other Trustee securities;

(c) Advances against readily marketable shares and debentures with in limit;

(d) Secured advances to agriculturists and small scale industries within reasonable limits.

(ii) At the time of renewal of an advance, a fresh credit report should be prepared only if there have been any significant change in the means and standing of the borrowers. In other cases, a remark should merely be recorded on the earlier credit report stating that the information has been verified and the party's position substantially remains unchanged or briefly indicating the minor changes that have occurred. A suitable remark to the same effect should also be made on the renewal proposal sent to the regional officer of the head office. However, a fresh credit report should be prepared at least once in two years.

(iii) Branches should not be required to send copies of credit reports to the head office or the regional office on borrowers to whom advances have been sanctioned under the agent's discretionary powers.

3. Credit Rating

Commercial banks rely on large extent on the reports and data supplied by reputed credit investigating agencies in developed countries like the U.K and the U.S.A. The agencies are specialized in collecting and providing credit information on individuals, partnerships and companies. Even the Indian Banks also favour such credit intelligence bureau. In India, credit rating and credit intelligence agencies have come up, which give rating to debt instruments. Some agencies like CRISIL, ICRA etc. have offered to provide services to commercial banks in this regard.

4. Scrutiny of Advances Proposals

Applications for advances of large amounts which are beyond the discretionary power of branch agents are referred to head office/ regional office by sending the proposal in the prescribed form. The branch agents should take into consideration the requirements for different types of facilities while assessing the credit requirement of a borrower. The head office/regional office should also give discretion to the branch agent to inter change the limits according to requirements from time to time. The bank should also verify the end use of funds to minimise the possibility of use of funds for anti-social purposes such as speculation, interlocking, overtrading, hoarding etc.

5. Supervision of Advances

The banks conduct the follow up action at the branch level for the periodical checking of operations of borrower, verification of the security, examination of stock statements submitted by the borrower in addition to the frequent visits by senior officials to borrowers place of business activities. In order to ascertain the end use of funds, the officials of bank during their visits should try to test check

(i) whether large drawings made from the accounts were for genuine business purposes,

(ii) whether the inflow of cash in the business was regularly deposited in the account,

(iii) whether the production and marketing activities of the concern have been running smoothly.

6. Management of Sick Accounts

It is not possible for a bank to eliminate the problem, difficult and sick accounts from the business of lending. The bank has to decide its policy regarding sick accounts and implement it. Narasimham Committee on financial systems made certain recommendations regarding such accounts by taking steps through a separate agency. Rending the non-performing assets (NPAs), prudential norms have to be observed. Government has also set up tribunals for the recovery of NPAs.

5.2 Types of Banks

Q3. Describe various types of banks.

(OR)

Write about different types of banks.

Ans : **(Aug.-21, Oct.-20, Imp.)**

Banks can be broadly classified into the following two types,

1. Central Bank

Central bank is an autonomous institution which holds immense powers and control over the entire banking system of the country. In India, the Reserve Bank of India (RBI) is the central bank of the country. According to R.R Kent "Central bank is the institution charged with the responsibility of managing the expansion and contraction of the volume of money in the interest of the general public welfare".

2. Commercial Bank

Commercial Banks are business enterprises which are involved in finances, financial instruments and provide financial services for a price which maybe in the form of interest, commission or a discount and so on. "They accept deposits of money from the public (savings), for the purpose of lending or investment (to meet working capital requirements or corporates)".

Commercial banks are classified into schedule and unschedule banks. They are as follows,

(a) Scheduled Commercial Banks

The Scheduled Commercial Banks (S.C.Bs) refers to those banks which have been included in the second schedule of RBI Act 1934, vice- versa for unscheduled CBs.

(b) Unscheduled Commercial Banks

Unscheduled Banks are the banks which are not included in the schedule of Banking Regulation Act, 1949. These types of banks can function in all banking sectors and there are no statutory restrictions on unscheduled banks.

Types

The other types of commercial banks are as follows,

1. Deposits Banks

It is one of the type of commercial bank which deals with short term deposit and loans. Deposit banks accepts deposits from the public and lend money to the customers who are in need of loans. Deposit banks extend loans for a short period ranging from 3 to 6 months.

2. Industrial Banks

Industrial banks extend long term loans to the industries which requires huge capital for buying heavy machineries and equipments. Moreover, they also deals with the process of buying shares and debentures of companies which would help the companies to hold fixed capital. Industrial banks perform the following functions,

(i) Accepting long-term deposits.

(ii) Extending long-term loans to the industries for fulfilling their credit needs

(iii) Helps the companies in dealing with the purchase and sales of shares and debentures.

3. Savings Banks

Savings banks are basically started with an aim to encourage the small savers like, poor or middle class customers to save their money in the form of deposits in these banks. However, in India due to absence or such banks, post offices performs the function of savings banks.

4. Agricultural Banks

Agricultural banks are of two types,

(i) Agricultural co-operative banks and

(ii) Land mortgage banks and co-operative bank. Agricultural banks are established to help the farmers by providing short, medium or long-term loans.

5. Exchange Banks

Exchange banks are the commercial banks which exclusively deals with the foreign trade such as, discounting, accepting and collecting foreign bills of exchange. They perform the functions of buying and selling foreign currency. These banks also provide services like that of the other ordinary banks.

5.3 Branch Banking

Q4. Define branch banking. Explain the merits and demerits of branch banking.

Ans : **(Aug.-21)**

Meaning

Under the branch banking system, a single commercial bank is a very big institution which spreads its branches across different geographic areas of the country. Branch banking is also known as "Delocalized Banking", as it allows the opening of a number of branches for performing the banking operations.

Branch banking system is quite famous in India.

The following are few Indian banks which follow branch banking system: State Bank of India (SBI), SBH, HDFC, ICICI, Yes Bank and so on.

These banks provide a variety of services such as, accepting deposits and cash withdrawals from a demand account with a bank teller, provide financial advice, insurance sales and so on.

Merits

Branch banking system has the following merits,

1. Economies of Scale

Branch banking system gets all the benefits of the economies of large-scale operations with the presence of greater applicability of the division of labour and specialization. The branch banks are usually large organization, thus they can appoint efficient personnels and can engage right person at the right place which would further result in efficient performance of the business operations.

2. Economy in Cash Reserves

Branch banking mostly results in economy in cash reserves. A branch bank may usually hold little more cash reserve at one branch and a bit little in another branch. In case of sudden cash requirement, cash can be transferred from one branch to another branch.

3. Economy of Costs

Branch banking allows the transfer of funds easily from one branch to another at a lower cost when compared to unit banking. This is due to the fact that indebtedness of inter-office can be adjusted without having an effect on the real transfer of funds.

4. Spreading Risks

A major advantage of branch banking system is that the risk of business operations is spread over a large geographical area. Basically, business of branch banks is independent in nature. Therefore, they can divide the risk with the help of diversification of the banking business, which helps in the reduction of failure rates.

5. Higher Degree of Safety

Branch banking helps in maintaining higher degree of safety and liquidity by providing greater scope for selecting among various investments and different securities and also because of their big size they possess good financial resources.

6. Provision of Complete Banking Service

Customers receive a complete package of service from branch banks. Thus, the customers can take the advantage of such services from any branch and need not depend upon a specific branch for a specific service. Further, branch banks are also present and function in rural areas in spite of incurring losses. Such losses are usually adjusted against the profits of urban branches of the bank.

7. Easy for Central Bank's Supervision

The country's central bank can easily control and monitor the activities of branch banks. It can control the complete banking system by controlling the head office of different banks.

Demerits

Branch banking system faces the following limitations/problems,

1. Mismanagement and Misappropriation

Branch banking usually carries out its business with the help of number of branches in various locations. This may result in mismanagement and there would be lack of supervision and control over the branches.

2. Delayed Decisions and Actions

A major limitation of branch banking is, delayed decision making.

The branch manager may not have the complete authority to take quick business decisions. Their decisions are dependent upon the directions of the head office and therefore needs their approval.

3. Absence of Personal Contact

Another limitation of branch banking is lack/

absence of personal contact with the customers. Branch banks are big in size and are spread over a large geographic area. Thus, the top level managers may not get a chance to have personal contact with the customers and staff members of the other branches.

5.4 Unit Banking

Q5. Define Unit Banking. Explain the merits and demerits of Unit Banking.

Ans : **(Aug.-21)**

Meaning

An independent unit bank is a corporation that operates one office and that is related to other banks through either ownership or control".

Under this type of banking system, the banking operations are usually subjected to merely a single office or in certain cases to some offices in the restricted local areas. Usually, unit banks provide services through a single bank and do not have any branches. Under the unit banking system, different units of banks perform their functions independently. It is also called as "localised banking".

It is quite popular in USA where different unit banks are clubbed together through a "correspondent banking system" which has the benefits of branch banking.

Merits

Unit banking system has the following advantages:

(i) Efficient Management

Unit banking possesses all the benefits of small scale operations. Because of the small size of the unit banks and centralized banking operations, there is less probability of mismanagement.

(ii) Fast Decision Making

As every unit bank performs its own functions independently, the decisions can be made quickly and efficiently.

(iii) Customer Friendly

Due to its small size, the unit banks can maintain personal and face-to-face contact with its customers. Maintaining such personal rapport helps in reducing the consumer complaints and grievances.

(iv) Cost Effective

Unit banks are more economical than the branch banks because of less number of operations and geographical coverage. This further results in greater profitability and lower costs.

(v) Decentralization

A unit bank can be opened with a small capital and with less number of formalities. The unit banking system usually encourages the decentralization of banking business and prevents monopoly of the banking business.

Demerits

The unit banking suffers from the following disadvantages,

(i) No Division of Labour

Due to its small size, division of labour and specialization cannot be followed in unit banks. This basically results in diseconomies of scale.

(ii) idle Cash Reserves

Unit banking usually needs large cash reserves because at any time, large withdrawals can be made and the unit banks are supposed to fulfil the cash requirements of its own branch. Thus, huge amount of cash usually lies idle with the bank.

(iii) Limited Mobility of Funds

The mobility of funds in unit banking is very less due to its local functioning. As a result, the speed of circulation and economic activities are decreased in the economy.

(iv) Limited Banking Services

Unit banks are small in size, and they offer only a limited number of services to their customers because of which the customers usually depend upon other branches for the other services.

(vi) Improper Supervision

Unit banks are difficult to be supervised and controlled because they function independently in various local areas according to the central banking authority and government. Thus this increases the chances of fraud or irreeularities.

Q6. Compare and contrast Unit Banking and Branch Banking.

Ans :

S.No.	Particulars	Branch Banking	Unit Banking
i)	**Loans and Advances**	Loans and advances are based on merit, irrespective of the status.	Loans and advances can be influenced by authority and power.
ii)	**Financial resources**	Larger financial resources in each branch.	Larger financial resources in one branch
iii)	**Decision making**	Delay in Decision-making as they have to depend on the head office.	Time is saved as Decision-making is in the same branch.
iv)	**Funds**	Funds are transferred from one branch to another. Underutilisation of funds by a branch would lead to regional imbalances imbalances or no balance growth	Funds are allocated in one branch and no support of other branches. During financial crisis, unit bank has to close down hence lead to regional
v)	**Cost of supervision**	High	Less
vi)	**Concentration of Power in the hand of few people**	Yes	No
vii)	**Specialization**	Division of labour is possible and hence specializations possible	Specializations not possible due to lack of trained staff and knowledge
viii)	**Competition branches**	High competition with the bank	Less competition within the
ix)	**Profits**	Shared by the bank with its branches	Used for the development of the bank
x)	**Specialized knowledge of the local borrowers**	Not possible and hence bad debits are high	Possible and less risk of bad debts
xi)	**Distribution of Capital**	Proper distribution of capital and power.	No proper distribution of capital and power.
xii)	**Rate of interest**	Rate of interest is uniformed and specified by the head office or based on instructions from RBI.	Rate of interest is not uniformed as the bank has own policies and rates.
xiii)	**Deposits and assets**	Deposits and assets are diversified, scattered and hence risk is spread at various places.	Deposits and assets are nt diversified and are at one place, hence risk is not spread.

5.5 Group Banking

Q7. Define Group Banking. Explain the merits and demerits of Group Banking.

Ans : **(Aug.-21)**

Meaning

Group Banking is that banking system in which two or more banks operate under the control of a holding company. Under group banking two or more banks are brought under the control of the same management through a holding company.

Definition

(i) Goldfield and Chandler "Group Banking refers to the system in which a corporation or a holding company operates two or more banks simultaneously".

Under group banking, a holding company controls and manages the functioning of its subsidiaries banks. There can be more than one bank under the control and management of the holding company. The holding company is popularly known as parent company and the group of banks operating under holding company is called operating companies or subsidiary companies.

Advantages

1. Efficient Management

The holding company stimulates efficiency of the group banks. The group banks are efficiently managed being under the overall control of Holding Company.

2. Economical

It is an economical system of banking, because many expenses such as advertisement and publicity are done collectively by the group as a whole under the direct control of the holding company.

3. Specialisation

In Group banking, different subsidiary companies tend to specialise in different aspects of banking. This promotes the overall efficiency of the group system.

Disadvantage

Main demerits of Group Banking are as under :

1. Rigid Control

There is rigid control in Group Banking due to lack of flexibility which often leads to corruption.

2. Less Mobility of Funds

Funds are less mobile in Group Banking than Branch banking system.

5.6 RRB

Q8. Explain briefly about RRB's.

Ans :

For Answer Refer Unit - II, Q.No. 13,14

5.7 Co-operative Banks

Q9. Define Co-operative Banks. Explain features of Co-operative Banks

Ans :

According to section 2(iv) of Maharashtra Co-operative Societies Act, I960, "Co-operative bank is a society which is doing the business oi banking". Co-operative banks are the financial or banking institutions which are established on the basis of co-operative principles and engaged in banking transactions like accepting deposits from public with a purpose to lend that deposits to others. Co-operative banks are voluntary organizations which open for all persons who are interested to use the services willingly and also ready to the responsibilities of membership without any discrimination of gender, caste, religion etc.

Features

Indian co-operative banks have the following features,

1. Principle of co-operation

The most important feature of co-operative banks is that they follow the principle of co-operation. The basic principles of co-operative banks are co-operation, self help and mutual help.

2. Equality Principle

These banks perform their functions on the basis of principles stating "one member, one vote" and functions on "No profit, no loss" basis.

3. Normal Banking Functions

The co-operative banks carry on all the common banking functions such as mobilising deposits, supplying credit and providing remittance facility and so on.

4. Less Number of Products

Some of the co-operative banks provide housing loans also but mostly co-operative banks deal with agricultural loans, grants etc.

5. Primary Credit Society

The co-operative banks play a crucial role in Indian money and capital market. They provide the short and longterm loans through the primary co-operative/agricultural credit societies (PCS's). Central and state co-operative credit societies provide short-term as well as term-loans. Longterm loans are provided by LDB's i.e., land development banks.

Objectives

The following are some of the objectives of cooperative banks,

1. To overcome the dominance of middleman and money lenders on ordinary people.
2. To offer financial resources to the individuals and farmers in the rural areas who are in need.
3. To participate in rural and micro financing.

5.8 Micro Finance

Q10. Define the term micro finance. What are the advantages of micro finance?

Ans :

Meaning

Microfinance refers to the provision of financial services to low-income clients, including consumers and the self-employed. The term also refers to the practice of sustainably delivering those services. Microcredit (or loans to poor micro enterprises) should not be confused with microfinance, which addresses a full range of banking needs for poor people.

It refers to a movement that envisions "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 transfers." Those who promote microfinance generally believe that such access will help poor people out of poverty.

Advantages

1. Better Loan Repayment Rates

Microfinance tends to target women borrowers, who are statistically less likely to default on their loans than men. So these loans help empower women, and they are often safer investments for those loaning the funds.

2. Extending Education

Families receiving micro financing are less likely to pull their children out of school for economic reasons.

3. Improved Health and Welfare

Micro financing can lead to improved access to clean water and better sanitation while also providing better access to health care.

4. Job Creation

Micro financing can help create new employment opportunities, which has a beneficial impact on the local economy.

5.9 NABARD

Q11. Write in detail about NABARD.

Ans :

For Answer Refer Unit - II, Q.No. 19

5.10 IDBI

Q12. Write in detail about IDBI.

Ans :

For Answer Refer Unit - II, Q.No. 22

5.11 Latest Trends in Banking

Q13. Discuss the Latest Trends in Banking.

(OR)

What are the latest trends in Banking?

Ans : **(Aug.-21)**

1. ATM

The automated teller machines refers to machines that deliver cash to customer of different banks and different countries. The automated Teller Machines are linked over the networks. The ATM and credit cards are linked over the network and facilitates the VISA and Master Card holders to withdraw cash from ATMs worldwide. ATMs have gained importance as most of the customers even today prefer cash payment for certain transactions. The non-banking organizations are also developing ATM networks. Therefore, the ATM networks are expanding rapidly.

The banks are also focusing on providing other facilities over the ATM networks. Most banks in India have introduced facilities such as, fund transfer, bill payment services, mobile phone recharge, etc.

2. E-Banking

The banking transactions which are undertaken/carried out via computers or other electronic items is termed as 'Electronic Banking' or 'E-Banking'. In simple words, e-banking refers to the performance of any or all banking transactions using the internet as a safe and secure platform for completing the banking transaction. The different types/ forms of E-banking are, Internet banking, ATM (Automated Teller Machine), Phone banking, Smart cards and PC banking.

3. Mobile Banking

Mobile banking refers to the process of carrying out any banking transaction through internet with help of mobile phone. The increasing use of mobile phones has led to the introduction of mobile banking. The developed countries provide the mobile banking services for payment of small value transactions at low cost. The mobile banking consists of two types of models, (a) The bank led model (b) The telecom led model. In India the bank-led model is used. The countries which don't have a wide spread banking network may use the telecom-led model.

4. E-Payment

An e-payment system is a building block of E-commerce which refers to the online exchange of money. This exchange is carried out over different platforms such as E-cash, E-check, credit cards etc. This system has been widely accepted around the world because of its hassle free process of converting money or funds into accepted form and it requires less amount of time for processing the expenses that occur under this system are relatively low when compared to paper based transactions.

5. Credit Card

Credit cards offer short term loans and credit to its card holders. The bills are drawn upon customers on a monthly basis for the purchases made by them using credit cards. The card holders have the options of clearing the complete amount or the minimum payment amount decided earlier i.e., 2 percent or 3 percent of outstanding amount. The card holder is granted a grace period and no interest is charged on loan during this period.

6. Online Banking

Online banking may be defined as a "Procedure that allows individuals to perform banking activities from home or the roads using an internet connection". Online banking is also known as e-banking, cyber banking, virtual banking or home banking. Some of the traditional banks also offer online banking facilities such as ICICI bank, State Bank of India etc. Also there are some other banks which do not have any physical identity, but they provide online services. Online banking enables customers to perform all routine transactions, such as account transfers, balance inquiries and bill payments. Some of the banks even offer online loan and credit card applications. It also allows the user to access an account information at any time (i.e., 24 hours a day, 7 days in a week and 365 days in a year).

7. Plastic Money

Plastic money refers to the replacement of currency notes into plastic cards. These plastic cards used in place of currency is known as the plastic money.

Plastic money's main objective is to ensure user's safety eliminating the risk of carrying cash. The postponement of actual payment or pre-purchase payment on the card issued are some of the other several objectives of plastic money.

8. Electronic Purse

Electronic purses are wallet sized smart cards that include a microchip for storing electronic money that a card holder utilizes for purchasing products or services. This have been developed by many financial companies as well as government organizations for meeting their demands for developing a financial device that substitutes paper cash.

When the required amount of electronic money is stored in electronic purse, it can be used for purchasing any product or service. The transaction of electronic purse is processed using electronic device that is embedded with a card reader. The two things that an electronic device needs to verify is, Authentication of card holder and Balance in the account (to know if there is sufficient money for the purchase).

When a purchase is made, the amount is deducted from the buyer's account immediately and saved in the electronic cash box. The balanced amount is displayed on the electronic machine or it can be checked by using balance reading device. When there is no amount left on electronic purse, it can be recharged again at any ATM center or using special telephone. The drawback of electronic purses is that they are very expensive.

9. Digital Cash

Digital Cash or Electronic cash is a form of electronic payment system which provides high level of security and reduces the overhead of paper cash. Because of its adaptable and flexible nature, it opened a way for new markets and applications.

It enables the merchants to think beyond the local markets. The merchants can now attract global customers because they can send and receive money throughout the world with just a mouse-click on their desktop. The currency limitations of a particular country can also be eliminated because, E-cash can be filed into and withdrawn from a smart card from anywhere and in any currency. It is also difficult to forge (duplicate) electronic cash than physical currency.

10. EFT

Electronic Fund Transfer (EFT) is defined as a process of transferring funds electronically from one financial institution to another. This type of electronic transfer started using different electronic devices like computers, telephone devices, electronic terminals, telecommunications devices. This transfer is done for ordering, instructing and authorizing a bank to debit/ credit an account.

Electronic fund transfer is different from traditional methods of payment that depends on physical delivery of cash by using physical means of transport.

11. ECS (Electronic Clearing System)

ECS stands for Electronic Clearing Service. In order to overcome the problems of financial instruments clearances, the electronic clearing system is used. This system efficiently handles bulk payments and bulk receipts. The ECS is growing at a rapid rate.

The following are the three components of Electronic Clearing System (ECS),

(a) ECS (Credit): This component facilitates bulk payments. It enables the institutions to make payments to large number of customers. For example: Payments of salaries, to employees or payment of interest to debenture holders etc.

(b) ECS (Debit): This component facilitates bulk receipts. It enables the institutions to collect receipts in bulk from several customers.

(c) ECS (Centralized): The NECs is the third party facility that is centralized and located at Mumbai Reserve Bank. The NECS (credit) and NECS (debit) provide facilities similar to ECE (credit) and ECS (debit).

12. Core Banking

Core banking is a banking service provided by a group of networked bank branches where customers may access their bank agent and perform basic transactions from any of the member branch offices. Core banking solution is defined as the set of powerful software components or integration of core banking components that are developed and tailored to satisfy the requirements of the individual businesses in order to face the challengers in the banking sector. The modules of core banking solution include saving bank account, current account, fixed deposits, cash credit, etc., and in addition include ATM and internet banking. While replacing the traditional solutions with core banking solution, banks should follow a holistic approach to minimize and effectively manage the risks associated with it.

13. Bank Assurance

The distribution channels set-up by banks for the purpose of selling insurance products is known as bank assurance. It is derived from the French term 'bank assurance' which was first introduced in 1980. Earlier French banks sold more insurance policies. However, the selling of insurance policies by banks became a common practice in most of the European countries and the United States. This practice was adopted even by most of the Asian Banks.

The increased population in India and a wide network of banks with low insurance penetration forced the Indian banks to enter into the insurance business.

5.11.1 ATM

Q14. Define the term ATM. What are the uses of ATM (Automated Teller Machine).

Ans : **(Dec.-21, May-19, Imp.)**

An automated teller machine is a computerized telecommunications device that provides the customers of a financial institution with access to financial transactions in a public space without the need for a human clerk or bank teller. ATM is designed to perform the most important function of bank. It is operated by plastic card with its special features. The plastic card is replacing cheque, personal attendance of the customer, banking hour's restrictions and paper based verification. These are debit cards. ATMs used as spring board for Electronic Fund Transfer.

ATM itself can provide information about customers account and also receive instructions from customers - ATM cardholders. An ATM is an Electronic Fund Transfer terminal capable of handling cash deposits, transfer between accounts, balance enquiries, cash withdrawals and pay bills. It may be online or offline.

The online ATM enables the customer to avail banking facilities from anywhere. In offline, the facilities are confined to that particular ATM assigned. Any customer possessing ATM card issued by the Shared Payment Network System can g< > to any ATM linked to Shared Payment Networks and perform his transactions.

Uses

Although ATMs were originally developed as just cash dispensers, they have evolved to include many other bank-related functions. In some countries, especially those which benefit from a fully integrated cross-bank ATM network (e.g., Multibanco in Portugal), ATMs include many functions which are not directly related to the management of one's own bank account, such as:

1. Deposit currency recognition, acceptance and recycling.
2. Paying routine bills, fees and taxes (utilities, phone bills, social security, legal fees, taxes, etc.).
3. Printing bank statements.
4. Updating passbooks.
5. Loading monetary value into stored value cards.
6. Purchasing :
   i) Postage stamps,
   ii) Lottery tickets,
   iii) Train tickets,
   iv) Concert tickets,
   v) Shopping mall gift certificates.
7. Games and promotional features.
8. Donating to charities.
9. Cheque Processing Module.
10. Adding prepaid cell phone credit.

Increasingly, banks are seeking to use the ATM as a sales device to deliver pre-approved loans and targeted advertising using products such as ITM (the Intelligent Teller Machine) from CR2 or Aptra Relate from NCR. ATMs can also act as an advertising channel for companies to advertise their own products or third-party products and services.

Q15. What are the different types of ATM.

Ans :

Following are the types of ATM's :

1. **Onsite ATM:** It is situated either within the branch premises or in very close proximity of the branch.
2. **Offsite ATM:** It is not situated within the branch premises but is located at other places, such as shopping centres, airports, railway and petrol stations
3. **Worksite ATM:** It is located within the premises of an organization and is generally for the employees of the organization
4. **Cash Dispenser:** It allows only cash withdrawal, balance enquiry, and mini statement requests Unlike an ATM, CD cannot be used for depositing cash or cheques.
5. **Mobile ATM:** It refers to an ATM that moves in various areas for the customers. Few private banks have introduced ATM on wheels.

Q16. Explain the merits and demerits of ATMs.

Ans :

Advantages

Following are the advantages of ATMs :

1. **To the Customer: It includes**
   i) Provide 24 × 7 and 365 days a year service.
   ii) Offer quicker and efficient service.
   iii) Allow privacy in transactions.
   iv) Are errors free.
   v) Enable cardholders to access cash at any location regardless of where they maintain their accounts.
   vi) Offer flexibility of cash withdrawal to the customer.
   vii) Enable fund transfers across branches or banks, in the linked accounts.
   viii) Offer anywhere banking facility.
2. **To the Banks: It includes**
   i) Is an alternative to extended banking hours.
   ii) Is cheaper if transactions are large in number, thereby, reducing footfall at the branches.
   iii) Alternative to opening new branches.
   iv) Reduces operating expenses of the banks.
   v) Helps banks to avoid transportation of cash and cash handling by the employees.
   vi) Increases market penetration.

Disadvantages

Following are the disadvantages of ATMs :

1. Up-front equipment acquisition cost or network participation fee.
2. Set-up fee to install and network the ATMs.
3. Usage fee, either per transaction or on a monthly basis.
4. Monthly or annual service fee for support.
5. Communications charges for dial-up, leased lines, or wireless data links.

5.11.2 E-banking

Q17. What is E-banking? and Explain the advantages and disadvantages in E-banking.

Ans : **(Dec.-21, Oct.-20, May-19, Imp.)**

Introduction

The banking industry is now a very mature one and banks are being forced to change rapidly as a result of open market forces such as threat of competition, customer demand, and technological innovations such as growth of internet banking. If banks have to retain their competitiveness, they must focus on customer retention and relationship management, upgrade and offer integration and value added services. With the increasing customer demands, banks have to constantly think of innovative customized services to remain competitive. That's why internet banking is becoming a necessity today.

Meaning

Electronic banking (E-banking) is a generic term encompassing internet banking, telephone banking, mobile banking etc. In other words, it is a process of delivery of banking services and products through electronic channels such as telephone, internet, cell phone etc. The concept and scope of E-banking is still evolving.

Electronic services allow a bank's customers and other stakeholders to interact and transact with the bank seamlessly through a variety of channels such as the internet, wireless devices, ATMs, on-line banking, phone banking and telebanking. Other services offered under E-banking include electronic fund transfer, electronic clearing service and electronic payment media including the credit card, debit card and smart card. On-line banking helps consumers to overcome the limitations of place and time as they can bank anywhere, anytime as these services are available twenty four hours, 365 days a year without any physical limitations of space like a specific bank branch, city or region. They also bypass the paper based aspect of traditional banking.

Advantages

1. **Convenience**

   Banks that offer internet banking are open for business transactions anywhere a client might be as long as there is internet connection. Apart from periods of website maintenance, services are available 24 hours a day and 365 days round the year. In a scenario where internet connection is unavailable, customer services are provided round the clock via telephone.

2. **Low Cost Banking Service**

   E-banking helps in reducing the operational costs of banking services. Better quality services can be ensured at low cost.

3. **Higher Interest Rate**

   Lower operating cost results in higher interest rates on savings and lower rates on mortgages and loans offers from the banks. Some banks offer high yield certificate of deposits and don't penalize withdrawals on certificate of deposits, opening of accounts without minimum deposits and no minimum balance.

4. **Transfer Services**

   Online banking allows automatic funding of accounts from long established bank accounts via electronic funds transfers.

5. **Ease of Monitoring**

   A client can monitor his/her spending via a virtual wallet through certain banks and applications and enable payments.

6. **Ease of Transaction**

The speed of transaction is faster relative to use of ATM's or customary banking.

7. **Discounts**

The credit cards and debit cards enables the Customers to obtain discounts from retail outlets.

8. **Quality Service**

E-Banking helps the bank to provide efficient, economic and quality service to the customers. It helps the bank to create new customer and retaining the old ones successfully.

9. **Any time Cash Facility**

The customer can obtain funds at any time from ATM machines.

Disadvantages

1. **High start-up Cost**

E-banking requires high initial start up cost. It includes internet installation cost, cost of advanced hardware and software, modem, computers and cost of maintenance of all computers.

2. **Security Concerns**

One of the biggest disadvantages of doing e-banking is the question of security. People worry that their bank accounts can be hacked and accessed without their knowledge or that the funds they transfer may not reach the intended recipients.

3. **Training and Maintenance**

E-banking requires 24 hours supportive environment, support of qualified staff. Bank has to spend a lot on training to its employees. Shortage of trained and qualified staff is a major obstacle in e-banking activities.

4. **Transaction Problems**

Face to face meeting is better in handling complex transactions and problems. Banks may call for meetings and seek expert advice to solve issues.

5. **Lack of Personal Contact between Customer and Banker**

Customary banking allows creation of a personal touch between a bank and its clients. A personal touch with a bank manager can enable the manager to change terms in our account since he/she has some discretion in case of any personal circumstantial change. It can include reversal of an undeserved service charge.

Q18. Explain the Risks involved in e-Banking.

Ans :

If internet banking has facilitated the banking service processes and made the customers life a lot easier, it has also thrown new challenges in terms of various risks which may affect the bank's profitability, capital and reputation as well. Let us discuss some of the risk issues related to the online banking.

1. **Operational Risk**

Operational risk is the price, which attaches to internet banking arising from error, fraud and inability to provide services to customers or deliver products as per the expectation, which may result in current and prospective loss to earnings of the bank. Inaccurate processing of transactions, non privacy and confidentiality, attacks or unauthorized access to banks systems and databases, weak technology adoption or systems design or human factors like lack of awareness on the part of employees or customers may lead to operational risk.

2. **Credit Risk**

Credit risk arises when a counter-party fails to settle an obligation when due or any time henceforth for its full value. In internet banking scenario the credit worthiness of the customer may not be properly evaluated. So any credit facilities provided to retail or corporate customers requires proper evaluation and constant audit of lending as well as the repayment progress at regular intervals to avoid such a risk.

3. Liquidity Risks

The bank may face liquidity crunch in short-term time horizon in internet banking scenario as well. In this case, the outflow of fund may be sudden and hence the banks, which are more exposed to internet banking, should ensure for sufficient liquidity in case of redemption or settlement demands.

4. Foreign Exchange Risk

Due to the geographical and market extension of banks and customers in internet banking scenario forex, legal and regulatory risk may arise. In cross border transactions there would be difficulty in correctly assessing the counter parties credentials and hence forex transaction against electronic money may lead to forex risk. Different international cross-border jurisdiction can expose banks to legal and compliance risks in view of different national rules, laws and regulations.

5. Security Risk

Security risk is one of very important issue in internet banking systems. In internet banking information is considered as an asset and so worthy of protection. Firewalls are frequently used on internet banking systems as security measure to protect internal systems and should be considered for any system connected to an outside network. Firewalls are a combination of hardware and software placed between two networks through which all traffic must pass, regardless of direction flow. They provide gateway to guard against unauthorized individuals gaining access to the bank's 'network. Therefore, awareness among the internet banking customers as well as adoption of security mechanism is essential.

6. Compliance Risk

The bank may face compliance and regulatory risk if it does not adhere or follow the guidelines given by the supervisor or the regulator. Due to lack of awareness and transparency the bank may fail in this matter and hence more care is required in this a.

7. Reputation Risk

A bank offering internet banking suffers reputation loss due to negative opinion if the systems failed or discontinued for a considerable time or when the banking products offered not found to their expectation or even the fraudulent activities by the internal/external people or hackers using bona fide customer's credentials. The bank-customer relationship may suffer due to this and this may also affect bringing prospective customers to its fold.

8. Legal Risk

Internet banking being a relatively a new phenomenon, the legal issues or risks are usually less crystallized or ambiguous. They may arise from the violation of, or non-conformance with laws, rules, and regulations or prescribed practices. A bank may also face legal actions from the customers in case of hushing attacks or any other fraudulent activities where the terms and conditions have not been framed adequately by the bank.

9. Strategic Risk

Strategic risk may emanate from adverse business decisions due to wrong implementation of unfavorable market conditions related to either the banking products offered through electronic channel, or any technology or strategic decisions like outsourcing policy, etc. Therefore, a proper market as well as technological survey is essential in this regard before taking any final decision.

10. Money Laundering Risk

In view of the lack of personal interaction among the bank staff and the customers in the internet banking scenario, the know your customers norms may not be implemented effectively as fund transfer transactions of dubious nature may be done by the offenders without much of hassles.

11. Interest Rate Risk

In case of electronic money becoming widely prevalent in the payment system, the interest rate risk and market risk will have an impact on the value of the banks assets against its electronic money liabilities.

Q19. Differentiate between traditional banking and e-banking.

Ans : **(Oct.-20)**

S.No.	Nature	Traditional Banking	E-Banking
1.	**Meaning**	Traditional banking refers to the banking transactions which are carried out by directly visiting banks or financial institutions.	E-banking refers to the banking transactions which are carried out via computers or other electronic devices.
2.	**Availability**	Under this, services are available during working hours only.	Under this, services are available at any time i.e., 24 hours access.
3.	**Time**	It consumes a lot of time to provide services.	It does not consume lot of time to provide services.
4.	**Security**	It does not face any e-security threats.	If faces many e-security threats such as hacking.
5.	**Customer Service**	Under this, only few customers can be attended at a time.	Under this, customers does not have to stand in queues to avail services.
6.	**Cost**	Traditional banks involves high operating and fixed costs.	As banks does not have any physical presence, operating and fixed costs are eliminated.
7.	**Visiting**	Customers are required to visit bank for any transaction.	There is no need of visiting banks, if customers have internet connection.
8.	**Contact**	Under this, customers can have face to face contact.	Under this, customers can only have electronic contacts with bank.

5.11.3 Mobile Banking

Q20. What is mobile banking? Explain various Technologies Enabling Mobile Banking.

Ans : **(Dec.-21, May-19, Imp.)**

Meaning

Mobile banking (also known as M-Banking, SMS banking, etc.) is a term used for performing balance checks, account transactions, payments, etc., via a mobile device such as a mobile phone. Mobile banking today is most often performed via SMS or the Mobile Internet but can also use special programs called clients downloaded to the mobile device.

Mobile Banking is the hottest area of development in the banking sector and is expected to replace the credit/debit card system in future. In past two years, mobile banking users have increased three times if it is compared with the use of either debit card or credit card. Moreover 85-90% mobile users do not own credit cards.

Mobile banking uses the same infrastructure like the ATM solution. But it is extremely easy and inexpensive to implement. It reduces the cost of operation for bankers in comparison to the use of ATMs.

Mobile banking is defined as "Mobile Banking refers to provision and availment of banking and financial services with the help of mobile telecommunication devices. The scope of offered services may include facilities to conduct bank and stock market transactions, to administer accounts and to access customized information".

Technologies

Technically speaking most of these services can be deployed using more than one channel. Presently, Mobile Banking is being deployed using mobile applications developed on one of the following four channels :

1. Interactive Voice Response (IVR)

IVR service operates through pre-specified numbers that banks advertise to their customers.

Customer's make a call at the IVR number and are usually greeted by a stored electronic message followed by a menu of different options. Customers can choose options by pressing the corresponding number in their keypads and are then read out the corresponding information, mostly using a text to speech program.

Mobile banking based on IVR has some major limitations that they can be used only for Enquiry based services. Also, IVR is more expensive as compared to other channels as it involves making a voice call which is generally more expensive than sending an SMS or making data transfer (as in WAP or Standalone clients).

One way to enable IVR is by deploying a PBX system that can host IVR dial plans. Banks looking to go the low cost way should consider evaluating Asterisk, which is an open source Linux PBX system.

2. Short Message Service (SMS)

SMS uses the popular text-messaging standard to enable mobile application based banking. The way this works is that the customer requests for information by sending an SMS containing a service command to a pre-specified number. The bank responds with a reply SMS containing the specific information.

For example, customers of the HDFC Bank in India can get their account balance details by sending the keyword 'HDFCBAL' and receive their balance information again by SMS. Most of the services rolled out by major banks using SMS have been limited to the Enquiry based ones.

However there have been few instances where even transaction-based services have been made available to customer using SMS.

The main advantage of deploying mobile applications over SMS is that almost all mobile phones, including the low end, cheaper one's, which are most popular in countries like India and China are SMS enabled.

3. Wireless Application Protocol (WAP)

WAP uses a concept similar to that used in Internet banking. Banks maintain WAP sites which customer's access using a WAP compatible browser on their mobile phones. WAP sites offer the familiar form based interface and can also implement security quite effectively.

Bank of America offers a WAP based service channel to its customers in Hong Kong. The banks customers can now have an anytime, anywhere access to a secure reliable service that allows them to access all enquiry and transaction based services and also more complex transaction like trade in securities through their phone.

4. Standalone Mobile Applications

Standalone mobile applications are the ones that hold out the most promise as they are most suitable to implement complex banking transactions like trading in securities. They can be easily customized according to the user interface complexity supported by the mobile. In addition, mobile applications enable the implementation of a very secure and reliable channel of communication.

Q21. Explain various Mobile Banking Services.

Ans :

Mobile banking can offer services such as the following :

1. Account Information: It includes

i) Mini-statements and checking of account history,

ii) Alerts on account activity or passing of set thresholds,

iii) Monitoring of term deposits,

iv) Access to loan statements,

v) Access to card statements,

vi) Mutual funds/equity statements,

vii) Insurance policy management

viii) Pension plan management,

ix) Status on cheque, stop payment on cheque,

x) Ordering cheque books,

xi) Balance checking in the account,

xii) Recent transactions,

xiii) Due date of payment (functionality for stop, change and deleting of payments),

xiv) PIN provision, Change of PIN and reminder over the Internet,

xv) Blocking of (lost, stolen) cards.

2. **Payments, Deposits, Withdrawals and Transfers: It includes**

i) Domestic and international fund transfers,

ii) Micro-payment handling,

iii) Mobile recharging,

iv) Commercial payment processing,

v) Bill payment processing,

vi) Peer to Peer payments,

vii) Withdrawal at banking agent, viii) Deposit at banking agent.

3. **Investments: It includes**

i) Portfolio management services,

ii) Real-time stock quotes,

iii) Personalized alerts and notifications on security prices.

4. **Support: It includes**

i) Status of requests for credit, including mortgage approval and insurance coverage,

ii) Check (cheque) book and card requests,

iii) Exchange of data messages and email, including complaint submission and tracking,

iv) ATM Location.

5. **Content Services: It includes**

i) General information such as weather updates, news,

ii) Loyalty-related offers,

iii) Location-based services.

Q22. Explain the Advantages and Disadvantages of Mobile Banking

Ans :

Advantages

Following are the advantages of mobile banking :

1. It utilizes the mobile connectivity of telecom operators and therefore does not require an internet connection.

2. With mobile banking, users of mobile phones can perform several financial functions conveniently and securely from their mobile.

3. People can check their account balance, review recent transaction, transfer funds, pay bills, locate ATMs, deposit cheques, manage investments, etc.

4. Mobile banking is available round the clock 24/7/365, it is easy and convenient and an ideal choice for accessing financial services for most mobile phone owners in the rural areas.

5. Mobile banking is said to be even more secure than online/internet banking.

Disadvantages

The disadvantages of mobile banking are as follows :

1. Mobile banking users are at risk of receiving fake SMS messages and scams.

2. The loss of a person's mobile device often means that criminals can gain access to mobile banking PIN and other sensitive information.

3. Modern mobile devices like Smart phone and tablets are better suited for mobile banking than old models of mobile phones and devices.

4. Regular users of mobile banking over time can accumulate significant charges from their banks.

5.11.4 E-Payment

Q23. Discuss briefly about E-payment

Ans :

An e-payment system is a way of making transactions or paying for goods and services through an electronic medium, without the use of cheques or cash. It's also called an electronic payment system or online payment system.

The electronic payment system has grown increasingly over the last decades due to the growing spread of Internet-based banking and shopping. As the world advances more with technology development, we can see the rise of electronic payment systems and payment processing devices. As this increase, improve, and provide ever more secure online payment transactions the percentage of cheque and cash transactions will decrease.

One of the most popular payment forms online are credit and debit cards. Besides them, there are also alternative payment methods, such as bank transfers, electronic wallets, smart cards or bit coin wallet (bitcoin is the most popular cryptocurrency).

E-payment methods could be classified into two areas, credit payment systems and cash payment systems:

1. **Credit Payment System**

   (a) **Credit Card:** A form of the e-payment system which requires the use of the card issued by a financial institute to the cardholder for making payments online or through an electronic device, without the use of cash.

   (b) **E-wallet: A** form of prepaid account that stores user's financial data, like debit and credit card information to make an online transaction easier.

   (c) **Smart card: A** plastic card with a micro processor that can be loaded with funds to make transactions; also known as a chip card.

2. **Cash Payment System**

   (a) **Direct debit:** A financial transaction in which the account holder instructs the bank to collect a specific amount of money from his account electronically to pay for goods or services.

   (b) **E-cheque:** A digital version of an old paper cheque. It's an electronic transfer of money from a bank account, usually checking account, without the use of the paper cheque.

   (c) **E-cash:** Is a form of an electronic payment system, where a certain amount of money is stored on a client's device and made accessible for online transactions.

   (d) **Stored-value card:** A card with a certain amount of money that can be used to perform the transaction in the issuer store. A typical example of stored-value cards are gift cards.

5.11.5 Credit Card

Q24. Define the term Credit Card. What are the advantages and disadvantages of credit card?

Ans :

Meaning

A credit card is part of a system of payments named after the small plastic card issued to users of the system. It is a card entitling its holder to buy goods and services based on the holder's promise to pay for these goods and services. The issuer of the card grants a line of credit to the consumer (or the user) from which the user can borrow money for payment to a merchant or as a cash advance to the user.

A credit card is different from a charge card, where a charge card requires the balance to be paid in full each month. In contrast, credit cards allow the consumers to 'revolve' their balance, at the cost of having interest charged. Most credit cards are issued by local banks or credit unions,

As well as convenient, accessible credit, credit cards offer consumers an easy way to track expenses, which is necessary for both monitoring personal expenditures and the tracking of work-related expenses for taxation and reimbursement purposes. Credit cards are accepted worldwide, and are available with a large variety of credit limits, repayment arrangement, and other perks.

Advantages

1. Purchasing Power

Credit Cards enable users to make big ticket purchases they might not otherwise be able to afford.

2. Rewards

Many cards offer rewards programs that will accrue points, discounts, or other benefits like frequent flyer miles.

3. Convenience

Credit cards reduce the need to carry cash. Most retailers accept credit cards and they are pretty much required for online purchases.

4. Trackability

The electronic record keeping that comes with credit cards make it easy to track your spending and identify fraud.

5. Use during an Emergency

There are times when money is the simple solution to an emergency. If you get hit with an unexpected expense, credit cards can be the quick and easy solution you need.

6. Builds Credit History

Responsible use of a credit card over time builds your credit history, qualifying you for better interest rates and other financial benefits.

Disadvantages

1. Overspending

Credit cards can make life easier, but they can also make overspending easier as well. With a credit card, you're spending money you don't necessarily have yet. If you're not careful, this can quickly lead to unexpected debt.

2. Interest and Fees

Using credit is essentially borrowing. And you're not borrowing for free. Mismanaging a credit card can lead not only to a high balance, or maxed-out card, but also to debt in the form of interest and fees.

3. Fraud

Credit cards (and other electronic forms of payment) carry unique dangers. Credit cards can be stolen, their numbers can be copied, and they can be used to steal your money and identity.

4. Mounting Debt

If you carry a balance on your credit card from month to month, it can be very easy for charges and interest to rack up. Many people don't expect credit cards to be gateways to extra debt, but if you're not careful, that's exactly what happens.

5.12 ONLINE BANKING

Q25. Define online banking. Explain the objectives of online banking.

Ans :

Meaning

Online banking may be defined as a "Procedure that allows individuals to perform banking activities from home or the roads using an internet connection". Online banking is also known as e-banking, cyber banking, virtual banking or home banking. Some of the traditional banks also offer online banking facilities such as ICICI bank, State Bank of India etc. Also there are some other banks which do not have any physical identity, but they provide online services.

Online banking enables customers to perform all routine transactions, such as account transfers, balance inquiries and bill payments. Some of the banks even offer online loan and credit card applications. It also allows the user to access an account information at any time (i.e., 24 hours a day, 7 days in a week and 365 days in a year).

Internet banking is changing the banking industry and is having the major effects on banking relationships. Banking is now no longer confined to the branches where one has to approach the branch in person, to withdraw cash or deposit a cheque or request a statement of accounts. In true Internet banking, any inquiry or transaction is processed online without any reference to the branch (anywhere banking) at any time. Providing Internet banking is increasingly becoming a "need to have" than a "nice to have" service. The net banking, thus, now is more of a norm rather than an exception in many developed countries due to the fact that it is the cheapest way of providing banking services.

Objectives

Following are the objectives of internet banking :

1. To provide services in users' own environment for convenience and accessibility.
2. To reduce risk of handling cash.
3. To provide low-cost and financial services to rural and under-serviced communities.
4. To provide a system that delivers efficient payments linked to a bank account.

Q26. Explain Uses of Online Bankings.

Ans :

One can avail the following services through internet banking :

1. Bill Payment Service

Each bank has tie-ups with various utility companies, service providers and insurance companies, across the country. One can facilitate payment of electricity and telephone bills, mobile phone, credit card and insurance premium bills as each bank has tie-ups with various utility companies, service providers and insurance companies, across the country. To pay the bills, simply complete a one-time registration for each biller. One can also set up standing instructions online to pay his/her recurring bills, automatically. Generally, the bank does not charge customers for online bill payment.

2. Fund Transfer

One can transfer any amount from one account to another of the same or any another bank. Customers can send money anywhere in India. Once the person log-in to his account, he needs to mention the payees's account number, his bank and the branch. The transfer will take place in a day or so, whereas in a traditional method, it takes about three working days. ICICI Bank says that online bill payment service and fund transfer facility have been their most popular online services.

3. Credit Card Customers

With Internet banking, customers can not only pay their credit card bills online but also get a loan on their cards. If anyone looses his/her credit card, he/she can report about the lost card online.

4. Investing through Internet Banking

One can now open an FD online through funds transfer. Now investors with interlinked demat account and bank account can easily trade in the stock market and the amount will be automatically debited from their respective bank accounts and the shares will be credited in their demat account. Moreover, some banks even give the facility to purchase mutual funds directly from the online banking system.

5. Recharging Prepaid Phone

Now just top-up prepaid mobile cards by logging in to Internet banking. By just selecting the operator's name, entering the mobile number and the amount for recharge, the phone is again back in action within few minutes.

6. Shopping

With a range of all kind of products, one can shop online and the payment is also made conveniently through the account. One can also buy railway and air tickets through Internet banking.

Q27. Explain the Advantages and Disadvantages of Online Banking.

Ans :

Advantages

1. 24 Hours Access

Unlike traditional banks, online banking sites never close, (they are available 24 hours a day, seven days a week, 365 days in a year).

2. Automatic Transfer of Funds to Pay Bills

Electronic payments from accounts are

usually credited the same day or the next. Electronic payment of bills involves very less expenses when compared to the postage involved in sending out large number of payments every month.

3. Offer Sophisticated Tools

Most of the online banking sites are now offering advanced tools which includes account aggregation, stock tenders and portfolio managing programs that helps the user (customer) in managing one's assets more effectively.

4. Import Account Transactions

Account transactions can easily be imported into money management software such as Quicken and Microsoft money.

5. Balance Accounts

Even if an individual fails to record ATM withdrawals, e-banking may help them to get arranged. Users can simply copy the transactions and import them into check registers.

6. Cost Reduction

Online banking reduces the cost of creating, processing, distributing, storing and retrieving paper-based information. High printing and postage costs are also reduced or sometimes eliminated.

7. Helps in Viewing the Images

It helps in viewing the images of bill statements, cheques and deposit slips.

8. Account Aggregation

It gives an opportunity to the individuals to view balances and market value of online accounts held at other institutions - including investments, credit cards, reward programs etc.

9. Access Account History

It helps the user in accessing account history (i.e.. deposits and withdrawals made by him in a month or in a year).

10. Transaction Speed

Online banking sites generally accomplish and confirm the transactions faster than the ATMs.

Disadvantages

i) In order to get registered with an online bank program, one has to provide his/her ID, and fill up the entire form at bank branch which may take some time.

ii) Even the largest banks repeatedly change their online programs adding new features to the unfamiliar places.

iii) When an account holder pays online, he/she has to put in a cheque request as much as two weeks before the due date of payment.

iv) The biggest problem with online banking is learning to trust it. Most of the times an individual may be in a dilemma whether his/her transaction has gone through or not, whether he/she pushed the transfer button once or twice.

v) It is difficult or impossible for online-only banks to offer some services such as travellers cheques and cashier's cheques.

5.12.1 Plastic Money

Q28. What is plastic money? Explain different types of plastic money.

Ans :

Meaning

Plastic money refers to the replacement of currency notes into plastic cards. These plastic cards used in place of currency is known as the plastic money.

Plastic money's main objective is to ensure user's safety eliminating the risk of carrying cash. The postponement of actual payment or pre-purchase payment on the card issued are some of the other several objectives of plastic money.

Types

There are various types of plastic money. Some of the common types of plastic money are as follows,

1. Credit Cards

In 1910, the first credit card was issued by sears. Later in 1949 the Diner's club was introduced. This card was operatable in multiple restaurants, that were the part of the scheme. The cards involved a small amount of or loan amount and had to be cleared in full within a month.

However, today credit cards offer short term loans and credit to its card holders. The bills are drawn upon customers on a monthly basis for the purchases major by them using credit cards. The card holders have the options of clearing the complete amount or the minimum payment amount decided earlier i.e., 2 percent or 3 percent of outstanding amount. The cord holder is granted a grace period and no interest is charged on loan during this period.

Credit cards are distributed using various means. Visa or master card are the most common general purpose cards. These cards are accepted by almost every merchant or retailer on a universal basis.

The credit cards are divided into three following types,

a) **Bank Cards:** The cards offered/ sponsored by individual banks and are used for general purpose are known as bank cards. Master card, visa maestro, etc., are some of the examples of bank cards. The bank charges annual fees, sets the credit limit and the terms and conditions.

b) **Travel and Entertainment Cards:** The cards used for paying travel and entertainment expenses are known as travel and entertainment cards. For example, American Express of Diner's Club.

c) **Company or Retail Store Cards:** The cards used company or retail store cards.

2. Debit Cards

The credit cards and debit cards look alike and provide similar benefits but are very different from one another. The credit card is a 'pay later' and the debit card is the 'pay now' card. The customers own account is debited when the debit card is used. Debit card does not facilitate credit facility.

The debit card is used by customers who are not willing to go in debt for meeting their wants. The debit cards do nor incure bills or charges and limit the customer expenses to their account balance.

Basically, debit cards follow two types of payment systems i.e., signature based or 'PIN based' transaction. The PIN is entered and the machine automatically calls the banks checks the customers account balance and deducts the balance with the transaction values. The PIN is only known to the user and his bank.

3. Other Payment Channels/Products These include the following,

a) **Automated Teller Machines (ATMs):** The customers even today value cash payments for various transactions. Therefore, the cash is being distributed on a regular basis through Automated Teller Machines (ATM). The credit card and ATM card networks are linked and these facilities can be enjoyed by their users. There has been a huge increase in the number of ATM machines in India. ATMs have increased from 35,000 in March 2008 to 44,000 in March 2009.

The ATMs have gained huge popularity in the recent year most banks have installed large amount of ATM machines to facilitate their customers and provide value added services such as funds transfer, bills payment etc.

b) **Mobile Banking:** The banks also use mobile as a mode for transactions. Mobile banking facilitates payments of small- value with relatively low fees and are therefore being used by customers in developing countries. There are two models for operating mobile banking. They are the bankled and the telecomled models. The countries having small number of banks use telecomled mode. In India the bank- led model is used.

The RBI issued guidelines for mobile banking transactions. They are,

i) A approval must be taken from RBI before providing mobile banking facility to customers.

ii) The facility should be provided only in Indian rupees.

iii) The banks should accept the prescribed technology and the safety measures and limits set.

c) Prepaid Payment Instruments: The prepaid payment instruments refer to the smart cards, magnetic strip cards, internet accounts, internet wallets, mobile accounts, mobile wallets etc. The values are stored in advance in such cards and debited once its used. The amount of value stored is the value either paid in cash, debit or credit by its holder. These instruments are convenient to use and are risk-free.

Q29. Explain the factors Effecting Utilization of Plastic Money.

Ans :

The various factors affecting utilization of plastic money are as follows :

1. **Modernisation :** It is lighter, smaller and easier to carry a card than amount of cash. In this modern era plastic money has increased the standard of living.

2. **Globalisation:** Plastic cards which known as plastic money accepted worldwide and a person keep the huge amount with him while going to anywhere in the world.

3. **Quick Service:** Through plastic money a person can purchase anything from anywhere without spending money on fare or cash transition. It is less time consuming and quick service process.

4. **Security (less cash burden):** It's a very safe way for a person to keep money every time with him.

5. **Less Botheration:** Provide a convenient payment method for purchases made on the Internet and over the telephone. So the person is less bothered of carrying cash with them every time.

6. **Add-On-Facility:** Mostly credit card offer additional benefits, as discount from some particular stores, bonus in airline fare, free insurance policies and much more. This discounts and bonus encourages a person to purchase more things as it is good for them.

7. **Home and Online Shopping:** Home and online shopping can be done through internet from plastic money in easier and convenient way.

8. **Other Factors:** The following are factors affecting the utilization of plastic money in India:

   i) Age of the customer,

   ii) Education level of the customer,

   iii) Monthly income of the customer,

   iv) Technological innovation,

   v) Age of the bank,

   vi) Reputation of the bank,

   vii) Lower bank charges.

Q30. What are the Uses and Limitations of Plastic Money?

Ans :

Uses

Following are the uses of plastic money:

1. Offer free use of funds, provided the customer to pay full balance in time.

2. It is more convenient to carry than cash.

3. Helps in establishing a good credit history.

4. Provide a convenient payment method for purchases made on the Internet and over the telephone.

5. Give incentives, such as reward points, that we can redeem.

Limitations

Following are the limitations of plastic money:

1. Cost much more than other forms of credit, such as a line of credit or a personal loan, if customer does not pay on time.
2. Damage customer credit rating if the payments are late.

5.12.2 Electronic Purse

Q31. Define the term Electronic Purse.

Ans :

Enclosed in a single card such as debit card or credit card , it is a smart card with an embedded microchip. It provides multiple uses, especially for types of payments.

Interest is fast developing in a multipurpose prepaid smart card commonly known as the electronic purse. In contrast to a debit card, the electronic purse is intended to facilitate a variety of small-value retail transactions and so is a clear substitute for currency. It might function as follows:

Monetary value would be loaded onto the card, with a corresponding debit to the cardholder's account at a financial institution. In a retail transaction, monetary value would be transferred from the purchaser's card into the merchant's terminal in an off-line mode. The value of consumer purchases made with electronic purses would accumulate in the merchant's terminal and would be transferred to the merchant's account at a financial institution from time to time through on-line transactions. More technically, in many purse systems the financial institution issuing the card would earmark or put a hold on an amount of funds in the cardholder's account that is equivalent to that recorded on the smart card, and would in effect be providing a guarantee of the value shown on the card. When a transaction is cleared through the payments system, a debit would be made to the cardholder's special suspense account, and a credit would be made to the merchant's bank account. This type of electronic purse would essentially function as an off-line debit card.

Q32. Explain the features of E-Purse.

Ans :

1. **Wallet in Smart Phone** : It is just like a wallet in pocket of customer but the difference is that it is stored in his smart phone or tablet as an app. It allow user to purchase items using smart-phone or online with a computer.
2. **Online Prepaid Account** : It is an online-prepaid account, linked with your bank account, debit card, or credit card of customer. It carries a preloaded monetary value and can be used as a means of payment for multiple small-value purchases.
3. **Storage of Money** : Customer can store money in e-wallet that he may use for cashless payment against any products or services without swiping your debit/credit cards. An E- wallet is protected with a password.
4. **Less Risk** : Unlike credit or debit cards, where holders have to be extra careful as they can have big balances or a huge credit limit, wallets can be loaded with small, or even exact amounts.
5. **Less Required Information** : Instead of entering information at every site with which the consumer want to do business, e-purse gives consumers the benefit of entering their information just once.
6. **Components of E-Wallet**: E-wallet has mainly two components, software and information. The software component stores personal information and provides security and encryption of the data. The information component is a database of details provided by the user which includes their name, shipping address, payment method, amount to be paid, credit or debit card details, etc.
7. **Use of Smart Phone** : It can be used in conjunction with mobile payment systems that allow customers to pay for purchases with their smart phones. When a digital wallet is used on a smart phone, it is referred to as a mobile wallet. It is a payment gateway/ services in which amount can be transferred to a payee account through a payment

application installed in the mobile. The amount can be transferred to payee account by entering the only mobile number or Aadhaar number that is linked to its bank account.

8. **Secure Purchasing** : It allows users to complete purchases quickly and securely with near-field communications technology.

9. **Low-level Details** : It hides the low-level details of executing the payment protocol.

10. **Storage of Information :** It stores the user's payment information securely and compactly which largely eliminate the need to carry a physical wallet.

11. **Digital Certification :** It employs digital certificates or other encryption methods to authenticate the user.

5.12.3 Digital Cash

Q33. Define the term Digital Cash. Discuss the model of Digital Cash transaction.

Ans :

Digital cash is a system of purchasing cash credits in relatively small amounts, storing the credits in your computer, and then spending them when making electronic purchases over the Internet. Theoretically, digital cash could be spent in very small increments, Most merchants accepting digital cash so far, however, use it as an alternative to other forms of payment for somewhat higher price purchases. There are several commercial approaches to digital cash on the Web. Among these are eCash from DigiCash and Cybercash.

Model of Digital Cash Transaction

1. A digital cash transaction generally involves three types of users :

   (a) A Payer (P) or Consumer

   (b) A Payee (R) or a Merchant

   (c) A Financial network like a bank with whom both payer and payee have accounts.

2. **A Digital Cash involves three transaction**

   (a) Withdrawal : The payer (P) transfer some digital coins from his account to his e-wallet which could be a computer or a smart case.

   (b) Payment: The payer (P) transfers the withdrawn digital coins to the payee's (R) wallet.

   (c) Deposit: The Payee (R) transfers the received digital coins to his account.

5.12.4 EFT (Electronic Funds Transfer)

Q34. Define the term EFT. Explain the advantages and disadvantages.

Ans :

An electronic funds transfer (EFT) is the electronic transfer of money over an online network. Electronic funds transfers can be performed between the same bank or a different one, and can be accomplished with several different types of payment systems. An EFT can be initiated by a person or by an institution like a business and often doesn't require much more than a bank account in good standing.

An electronic funds transfer is a widely used method for moving funds from one account to another using a computer network. Electronic funds transfers replace paper-based transfers and human intermediaries, but provide the customer with the convenience of doing her own banking.

Every time a banking customer uses her credit or debit card, whether at a physical point -of-sale or online, she's engaging in an electronic funds transfer. Any preauthorized charges, such as direct deposits or utility bills, also utilize an EFT.

Certain services use EFTs to create a peer-to-peer payment environment. In such a situation, the sender simply uses an app or website to indicate that she wants to send money to a recipient. Often, this means sending money from a bank account to another bank account, but it can sometimes mean transferring it to the service itself, from where the recipient can withdraw the funds into her bank account manually.

Electronic funds transfers are secured by a personal identification number (PIN) or the login information that unlocks the customer's online banking service. An automated clearing house (ACH) processes the payment.

With online banking, you can make your own EFTs. Open a savings account to get started.

Example:

The most popular form of electronic funds transfer is a direct deposit, in which an employee of a company preauthorizes her employer to pay her salary directly into her bank account. However, numerous other electronic funds transfers exist, including the following:

- ATMs.
- Online peer-to-peer payment apps like PayPal and Venmo.
- Pay-by-phone systems.
- Wire transfers.
- Online or mobile banking.

Advantages

- Saves time by simplifying the payment process.
- Convenience: Can be done sitting comfortably at home
- Saves money through cashback & discount
- Safe & secure
- Works 24/7
- Cash flow management
- Paperless
- Faster
- User-friendly
- Anytime, anywhere banking
- Helps in customer loyalty & retention
- Efficient
- No fear of loss or destruction
- Widely accepted by all
- Makes traditional Branch Banking redundant

Disadvantages

However, there are a few drawbacks too as far as EFTs are concerned. Some of them are:

- Highly technical. Not for everyone
- Fear of account being hacked
- Enhanced privacy breach risk
- Limit on daily transactions
- Limit on the maximum amount to be withdrawn daily
- Chances of identity theft by unscrupulous elements
- Needs a computer terminal or access to the internet at all times
- Crimes like phishing, credit cards theft have increased
- Leads to impulse buying behavior
- Not for illiterates
- Fraudulent bank websites are on the rise
- Dependency on the power supply
- Some might prefer paper money to "virtual currency".
- Decreased human interactions
- Over-reliance on technology

Q35. Explain different types of EFT.

Ans :

1. Real Time Gross Settlement (RTGS)

RTGS as the name suggests is a real time funds transfer system which assists the customer to transfer funds from one bank to another in real time or on a gross basis. The transaction is not put on a waiting list and cleared out instantly. Reserve Bank of India maintains RTGS payment gateway which makes transactions between banks electronically. The transferred amount is instantly deducted from the account of one bank and credited to the account of other bank. Individuals, companies or business firms can transfer large amount using the RTGS system. The minimum value that can be transferred by using RTGS is ` 20,000 and above. There is no upper limit on the amount that can be transacted through

RTGS. The remitting customer requires to add the beneficiary and his bank account details prior to transacting funds through RTGS.

Features of RTGS

(i) A system to promote e-payments and paperless banking.

(ii) Funds of ` One Lac and above, of corporate and Retail Customers, eligible for Transfer under the scheme.

(iii) Facility available at all Centralised Banking Solution Branches of the Bank.

(iv) It eliminates Risk of loss of instrument or its fraudulent use.

(v) The facility is also available online through banks' Internet Banking Channel.

(vi) A more efficient alternative to High value Clearing Cheques.

(vii) Cheaper than Traditional Mode of Remittance i.e. Drafts/Telegraphic Transfer.

(viii) The RBI's timing for settlement of transactions are 9.00 AM to 4.00 PM, on week days and from 9.00 AM to 12.00 Noon on Saturdays.

2. National Electronic Fund Transfer Service (NEFT)

National Electronic Fund Transfer is a nationwide money transfer system which allows customers with the facility to electronically transfer funds form their respective bank accounts to any other account of the same bank or any other bank network.NEFT needs a transferring bank and a destination bank for fund transfer. Almost all the banks are enabled to perform a NEFT transaction with the RBI organizing the records of all the bank branches at a centralized database. The customer registers the beneficiary, receiving the funds before transferring the funds. For this purpose the customer must possess the information such as the recipient, bank of recipient, a valid account number belonging to the recipient and IFSC code of respective bank of recipient.

Features of NEFT

(i) Another system to promote e-payments and paperless banking with no minimum or maximum limit.

(ii) Facility available to both Retail and Corporate Clients.

(iii) Ensures remittance of funds on the same day.

(iv) Eliminates Risk of loss of instrument or its fraudlent use.

(v) Facility available at all CBS Branches and identified Non-CBS Branches of the bank.

(vi) The facility is also available to corporate and Retail customers through Internet Banking Channel (as Request option).

(vii) Cheaper than Traditional mode of remittance i.e Drafts/Telegraphic Transfer.

5.12.5 ECS (Electronic Clearing System)

Q36. Explain briefly about ECS.

Ans : **(Oct.-20)**

ECS is an electronic mode of funds transfer from one bank account to another. It can be used by institutions for making payments such as distribution of dividend interest, salary, pension, among others. It can also be used to pay bills and other charges such as telephone, electricity, water or for making equated monthly installments payments on loans as well as SIP investments. ECS can be used for both credit and debit purposes.

Advantages

The benefits of ECS credit given to the clients are as follows:

1. The end beneficiary need not make frequent visit to his bank for depositing the physical paper instruments.

2. Delay in the realisation of proceeds, which used to happen in the receipt of the paper instrument, is eliminated.

3. The ECS user helps to save on administrative machinery for printing, dispatch and reconciliation.

4. Provides the ability to make payment and ensure that the beneficiaries account gets credited on a designated date.

5.12.6 Safeguard for Internet Banking

Q37. Explain Safeguard for Internet Banking.

Ans :

(i) **Network and Database Administrator :** Banks should designate a network and database administrator with clearly defined roles as indicated in the Group report.

(ii) **Security Policy :** Banks should have a security policy duly approved by the Board of Directors. There should be a segregation of duty of Security Officer/Group dealing exclusively with information systems security and Information Technology Division which actually implemented the computer systems. Further, Information systems Auditor will audit the information systems.

(iii) **Logical Access Control :** Banks should introduce logical access controls to data, systems, application software, utilities, telecommunication lines, libraries, system software, etc. Logical access control techniques may include user-ids, passwords, smart cards and other biometric technologies.

(iv) **Use of Proxy Server :** At the minimum, banks should use the proxy server type of firewall so that there is no direct connection between the Internet and the banks system. It facilitates a high level of central and in-depth monitoring using logging and auditing tools. For sensitive systems, a stateful inspection firewall is recommended which thoroughly inspects all packets of information, and past and present transactions are compared. These generally include a real time security alert.

(v) **Dial Up Services :** All the systems supporting dial up services through modem on the same LAN as the application server should be isolated to prevent intrusions into the network as this may by pass the proxy server

5.13 Comparison of Traditional Banking and E-banking

Q38. Compare and contrast Traditional Banking and E-banking.

Ans :

S.No.	Nature	Traditional Banking	E-Banking
1.	Presence	Banks exist physically for serving the clients.	E-Banks do not have physical presence as services are provided online.
2.	Time	It consumes a lot of times as clients have to visit banks to perform bank transactions like checking bank balances, transferring money from one account to another.	It does not consume times as clients do not have to visit banks to check bank balances or to transfer money from one account to another.
3.	Accessibility	Customers have to visit the banks only during the working hours.	E-Banking is available at any time. It provides 24 hours access.
4.	Security	Traditional banking does not face e- security threats.	E-Banking is tempting target for hackers. Security is one of the major problems faced by customers.
5.	Expensive	Customers have to spend money for visiting banks.	Customers do not have to spend money for visiting banks.
6.	Cost	The cost incurred by traditional banks includes a lot of operating and fixed costs.	The operating and fixed costs are eliminated as banks do not have physical presence.
7.	Customer Service	In traditional banks, the employees and clerical staff of the bank can attend only few customers at a time.	In E-Banking, the customers do not have to stand in queues to carry on certain bank transactions.
8.	Contact	Clients can have face to face contact in traditional banking.	Clients can only have electronic contacts with bank.

5.14 MSME'S

Q39. What do you mean by Micro Small and Medium Enterprise (MSME)? Outline the recent performance of the MSME sector.

Ans : **(Dec.-21, Aug.-21, May-19, Imp.)**

The government of India is providing strong emphasize on the development of Micro Small and Medium Enterprises (MSME) as it helps to generate mass employment and helps in quick and balanced regional development in the country.

Definition

According to the MSME Act of 2006, enterprises are categorized as micro, small or medium on the basis of investment. The MSME Act 2006 provides the following definitions,

(a) Manufacturing Enterprise

Micro Enterprise : "A micro enterprise is one in which the total investment in plant and machinery must not exceed rupees 25 lakhs.

Small Enterprise : A small enterprise is one in which the total investment in plant and machinery should range between 25 lakhs to 5 crores.

Medium Enterprise : A medium enterprise is one in which the total investment in plant and machinery must range between 5 crores to 10 crores.

(b) Service Enterprise

Micro Enterprise : A micro enterprise is one in which the total investment in equipments does not exceed rupees 10 lakhs.

Small Enterprise : A small enterprise is one in which the total investment in equipments is more than rupees ten lakh, but should not go beyond ` 2 crores.

Medium Enterprise : A medium enterprise is one in which the total investment in equipments is more than rupees two crores but should not exceed rupees five crores.

Recent Performance of the MSME Sector

The MSME sector has performed significantly well during the past few years. For instance, as per the third all India Census, there were about 105.21 lakh MSME enterprises operating in India, which produced goods of worth ? 282,270 crores and have provided employment to around 2.5 crore individuals. The MSME performance can be discussed under the following sub-headings,

(a) Infrastructure Development

The government has initiated Micro and Small Enterprise Cluster Development Program (MSECDP) for bringing development in the overall performance of MSME sector. Under this scheme. Integrated Infrastructural Developmental (IID) units were established (each at a cost of five crore).

The main function of IID is to upgrade and strengthen MSME units of the country.

(b) Use of Technology in MSME Sector

There has been substantial upgradation of technology in the MSME sector. The government has taken the following measures to make MSME's globally competitive.

(i) Providing financial assistance for establishing/ upgrading/expanding the testing centers.

(ii) Established regional testing centers for conducting quality testings of products before actually introducing them into the markets.

(iii) Established the biotechnology cells at different parts of the country.

(c) Export Promotion

There had been substantial increase in the exports by MSME's over the past few years, as shown by the table.

Year	Exports by MSME (in crores)
2002-03	86,013
2003-04	97,644
2004-05	124,417
2005-06	150,242

The government has taken the following steps for encouraging more exports by MSME's.

1. Products manufactured by MSMEs are exhibited/ displayed at international exhibitions whose expenditures were borne by the government.
2. Conduct training programs to familiarize MSME's with the latest packaging for exports.
3. Under the MSME marketing development program, assistance is provided to individual units for participating in overseas tours/ exhibitions.

It is clearly observed from the above information that the MSME sector in India has substantially developed during the past few years.

Q40. Discuss in detail the significance of MSMEs.

Ans :

MSMEs play a significant role in the overall economic development of a country. They act as the engines of economic development. Infact, in many developed countries about 90% of the total enterprises constitute MSMEs which help to provide the highest rate of employment.

The significance of MSME's can be studied as follows,

1. Provide Mass Employment

MSME's provide employment to large number of people residing in both rural and urban areas. For a country like India where there is a scarcity of capital and there is an existence of huge population, SMSE's play a crucial role in employment generation.

Year	People Employed (in lakhs)
2002-03	263.68
2003-04	275.30
2004-05	287.55
2005-06	299.85
2006-07	312.52

Table: Showing the Number of People Employed in Indian SMSEs

2. Equi-distribution of Wealth

MSMEs play a vital role in the equitable distribution of wealth in the country as the capital is not accumulated with, few large industrial units. It is distributed among large number of entrepreneurs.

3. Increased Production

MSMEs help in improving the production of goods and services in a country. This can be done by optimally allocating the resources and also by utilizing the ideal capacities of the labour. In the year (2007-08) almost 40% of the total industrial output whose worth was found to be ` 6,95,126 crores was the contribution of MSMEs.

4. Labour Intensive

MSMEs require less capital and are more labour intensive. Thus they play a special role in India, which has a huge human resource and score capital.

5. Production of Artistic Goods

These enterprises play a substantial role in the production of artistic goods such as Banarsi Sarees, Kashmiri Carpets and other handicraft goods. In 2007-08, handicraft of worth ` 6,600 crores were exported from India.

6. Serve as Ancillary Units

MSME enterprises act as complimentary/ ancillary units for large scale industries by producing and supplying spare parts and other components. For instance, small nuts and other components required for the production and assembly operations of automobiles can be produced by MSMEs.

7. Role in Exports

Micro, Small and Medium Enterprises (MSMEs) play an important role in promoting the exports of any country. In the year 2006-07, such small enterprises exported goods worth around rupees 1,81,000 crores.

8. Resource Utilization

As these enterprises are spread across the countries, the latent and unexploited resources can be optimally allocated and utilized. This helps the .MSMEs in the overall development of the country.

9. Short Gestation Period

In industrial terms, gestation period refers to the time interior between the setting up of an industry and the actual initiation of production operations. SMSEs has a shorter gestation period when compared to large enterprises.

Thus, it has been observed the aforementioned information that micro, small and medium enterprises (MSMEs) play a significant role in the overall development of any country.

Q41. Discuss about Role and Importance of MSME.

Ans :

1. Large Employment Opportunities

MSMEs are generally labour-intensive. For every Rs. 1 lakh of fixed investment, MSME sector provides employment for 26 persons as against 4 persons in the large scale sector. Thus in a country like India where capital is scarce and labour is abundant, MSMEs are especially important.

2. Economical Use of Capital

MSMEs need relatively small amount of capital. Hence it is suitable to a country like India where capital is deficient.

3. Balanced Regional Development

Generally small enterprises are located in village and small towns. Therefore it is possible to have a balanced regional growth of industries. India is a land of villages.

4. Equitable Distribution of Income And Wealth

It removes the drawbacks of capitalism, abnormal profiteering, concentration of wealth and economic power in the hands of few etc.

5. Higher Standard of Living

MSMEs bring higher national income, higher purchasing power of people in rural and semi-urban areas.

6. Mobilization of Locals Resources

The spreading of industries even in small towns and villages would encourage the habit of thrift and investment among the people of rural areas.

7. Simple Technology

New but simple techniques of production can be adopted more easily by MSMEs without much investment.

8. Less Dependence on Foreign Capital

MSMEs use relatively low proportion of imported equipment and materials. The machinery needed for these industries can be manufactured within the country.

9. Promotion of Self Employment

MSMEs foster individual skill and initiative and promote self-employment particularly among the educated and professional class.

10. Promotion of Exports

With the establishment of a large number of modern MSMEs in the post independence period, the contribution of the small scale sector in the export. Earnings has increased much.

11. Protection of Environment

MSMEs help to protect the environment by reducing the problem of pollution.

12. Shorter Gestation Period

In these enterprises the time-lag between the execution of the investment project and the start of flow of consumable goods is relatively short.

13. Facilitate Development of Large Scale Enterprises

MSMEs support the development of large enterprises by meeting their requirements of inputs of raw materials, intermediate goods, spare parts etc. and by utilizing their output for further production.

Q42. Explain problems of MSMEs.

Ans :

Some of the more important problems faced by MSMEs are as follows:

1. Lack of Managering Experience

They may not be having specialised knowledge in the different fields of management. At the time of initiating the project, they are not in a position to anticipate correctly their financial requirements and the size of market for their products.

2. Inadequate Finance

Generally MSMEs are not in a position to arrange full finance from their own sources. They obtain finance from unorganized finance sector at higher rate of interest.

3. Lack of Proper Machinery and Equipment

Many MSMEs use inefficient and outdated machinery and equipment. This affects the quality of production.

4. Lack of Technical Know-How

Do not have the knowledge about different alternative technologies and processes available for manufacturing their products to improve the quality of products and reduce costs.

5. Run on Traditional Lines

They have not yet adopted modern methods and techniques of production. They have not taken adequate interest in research and development efforts. Hence they cannot be run efficiently.

6. Irregular Supply of Raw Materials

The majority of MSMEs depends on local sources for their raw material requirements. Small entrepreneurs are forced to pay high prices for materials because they purchase materials in small quantity.

7. Problem of Marketing

The brand name of the products of MSMEs is acute due to tough competition from large industries. It cannot afford to costly advertisement and network of distribution system. There are delays in the payment of bills by large purchasers resulting in inadequate working capital.

8. Personal Problems

It is difficult for them to get qualified persons to run the business. They cannot provide much training facilities to employees.

9. Lack of Clear-Cut Policy of the Govt.

The Govt, may take decisions relating to MSMEs on the basis of political consideration rather than on economic consideration.

10. Bogus Units

The government should look into this aspect seriously, break the strong hold of such vested-interested and promote only genuine entrepreneurship in the country.

11. Other Problems

Like inefficient management, non-availability of cheap power, burden of local taxes etc.

5.15 Role of Foreign Banks

Q43. Define Foreign Banks. State the features of Foreign Banks.

Ans : **(May-19)**

Foreign banks are those banks which are registered or incorporated outside India, and having a branch in India. These banks are also controlled and supervised by RBI. At present the Reserve Bank of India has allowed the foreign banks to establish the banking business in India through a single mode of presence i.e. either branch mode or a wholly owned subsidiary mode. The number of foreign banks have increased in India with the changes in the banking policy after 1993.

Some of the foreign banks having a work place in India are listed below :

1. HSBC
2. Standard Chartered Bank
3. Citibank
4. Bank of America

Features

1. The main task of Foreign banks are to finance Indian exporters. It leads to regular supply of foreign exchange for India.
2. Foreign Banks develop commercially viable relationships with target set of externally oriented companies.
3. Foreign Banks act as information banks. It collects variety to analytical information and export related services and make available for Indian exporters.
4. Foreign Banks provide fee based services to exporters which helps in identifying new business propositions, source trade and investment create and develop joint network of institutional linkages across the world.

Q44. Describe the role of Foreign Banks.

(OR)

What is the role of Foreign Banks?

(OR)

Write about the role played by foreign banks?

Ans : **(Dec.-21)**

1. It grants loans to the persons solely or jointly in India with commercial banks to exporters and importers of India.
2. It advances loan facilities to government, financial institutions and other suitable organisations in foreign countries.
3. It finances on lease basis to export and import heavy and costly machinery and equipment.
4. It lends for joint ventures abroad.
5. It performs the limited functions of merchant banking such as underwriting of stocks, share of companies involved in export or export.
6. Foreign Banks provide financial, technical and administrative help to trader in foreign trade.
7. It assists in purchasing, discounting and negotiating the export bills.
8. Bank issues letters of credit on behalf of exporters in India.
9. It purchases and sells the foreign currencies.

5.15.1 Advantages & Disadvantages of Foreign Banks

Q45. Explain the Advantages & Disadvantages of Foreign Banks

Ans : **(Dec.-21, May-19, Imp.)**

Advantages

(A) Loans to Indian Companies

(i) Deferred Payment Exports

Foreign Banks provide term finance to Indian exporters to eligible goods and services. It enables the exporters to provide differed credit to overseas buyers. Commercial banks participate in directly or risk syndication programmes.

(a) **Preshipment Credit:** Foreign Banks offer finance to Indian companies executing export contracts involving cycle time exceeding six months.

(b) **Long Term Loans for Export Production:** Term loans are provided by Foreign Banks to 100% export-oriented units, units in free trade zones and computer software exporters.

(c) **Overseas Investment Finance:** Foreign Banks provide finance to Indian companies establishing joint venture abroad towards their equity contribution in joint venture.

(d) **Finance for Export Marketing:** Foreign Banks assist the exporters to implement their export market development plans.

(ii) Loans to Foreign Governments, Companies and financial Institutions:

(a) **Credit to Overseas Buyers:** Banks directly offer credit to foreign companies for import of eligible goods on deferred payment.

(b) **Lines of Credit:** Finance is made available by Foreign Banks to foreign financial institutions and government agencies to the respective country for import of goods and services from India.

(iii) Refinance Facility to Foreign Banks: Bank provides refinance facilities to foreign banks to enable them to offer term loan to their customers world-wide for imports from India.

(B) Loans to Commercial Banks in India

(i) Rediscounting of Export Bills: Foreign Banks rediscount the short term export bills (an unexpired unance period of not more than 90 days) of Indian commercial banks who are the authorised to deal in foreign exchange.

(ii) Relending of Export Credit: Foreign Banks provide 100% refinance of deferred payment loans of authorised dealers in foreign exchange for export of eligible Indian goods.

(iii) Guaranteeing of Obligations: Guarantees for export contracts and execution of overseas construction and important projects required by Indian companies is given by Foreign Banks along with commercial banks in India.

(iv) Export Credits. Bank provides credit to export of Indian machinery, manufactured goods, consultancy and technology services on deferred payment terms. Bank undertakes the financing activities to overseas entities *i.e.* governments, Central banks, commercial banks for financing export of goods and services from India.

(c) Export Services Provided by Foreign Banks

Foreign Banks provide different types of analytical information and export related services. These services include identify new business prospects, source trade and investment search for overseas partners, identification of technology suppliers, development of joint venture in India or abroad.

Disadvantages

1. Targeting Creditworthy Borrowers

Foreign banks existence attract best domestic borrowers, due to which domestic banks are forced to lend money to less creditworthy borrowers.

2. Attracting Multinational Corporations

Foreign banks attract foreign agencies, international farms and multinational corporations because of their relationship with parent bank and home country contacts.

3. Priority to Foreign Customers

Foreign banks usually gives priority to foreign customers like NRI. Due to which the services available for foreign customers will not be applicable for domestic customers.

4. Influence of Regulation

The impact of Indian banking regulations i s always less on foreign banks compare to the impact on domestic banks.

Short Question and Answers

1. What do you mean by Micro Small and Medium Enterprise (MSME)?

Ans :

According to the MSME Act of 2006, enterprises are categorized as micro, small or medium on the basis of investment. The MSME Act 2006 provides the following definitions,

(a) Manufacturing Enterprise

Micro Enterprise : "A micro enterprise is one in which the total investment in plant and machinery must not exceed rupees 25 lakhs.

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Micro Enterprise : A micro enterprise is one in which the total investment in equipments does not exceed rupees 10 lakhs.

Small Enterprise : A small enterprise is one in which the total investment in equipments is more than rupees ten lakh, but should not go beyond ` 2 crores.

Medium Enterprise : A medium enterprise is one in which the total investment in equipments is more than rupees two crores but should not exceed rupees five crores.

2. Define online banking.

Ans :

Meaning

Online banking may be defined as a "Procedure that allows individuals to perform banking activities from home or the roads using an internet connection". Online banking is also known as e-banking, cyber banking, virtual banking or home banking. Some of the traditional banks also offer online banking facilities such as ICICI bank, State Bank of India etc. Also there are some other banks which do not have any physical identity, but they provide online services.

Online banking enables customers to perform all routine transactions, such as account transfers, balance inquiries and bill payments. Some of the banks even offer online loan and credit card applications. It also allows the user to access an account information at any time (i.e., 24 hours a day, 7 days in a week and 365 days in a year).

Internet banking is changing the banking industry and is having the major effects on banking relationships. Banking is now no longer confined to the branches where one has to approach the branch in person, to withdraw cash or deposit a cheque or request a statement of accounts. In true Internet banking, any inquiry or transaction is processed online without any reference to the branch (anywhere banking) at any time. Providing Internet banking is increasingly becoming a "need to have" than a "nice to have" service. The net banking, thus, now is more of a norm rather than an exception in many developed countries due to the fact that it is the cheapest way of providing banking services.

3. ECS.

Ans :

ECS is an electronic mode of funds transfer from one bank account to another. It can be used by institutions for making payments such as distribution of dividend interest, salary, pension, among others. It can also be used to pay bills and other charges such as telephone, electricity, water or for making equated monthly installments payments on loans as well as SIP investments. ECS can be used for both credit and debit purposes.

4. ATM

Ans :

An automated teller machine is a computerized telecommunications device that provides the customers of a financial institution with access to financial transactions in a public space without the need for a human clerk or bank teller. ATM is designed to perform the most important function of bank. It is operated by plastic card with its special features. The plastic card is replacing cheque, personal attendance of the customer, banking hour's restrictions and paper based verification. These are debit cards. ATMs used as spring board for Electronic Fund Transfer.

ATM itself can provide information about customers account and also receive instructions from customers - ATM cardholders. An ATM is an Electronic Fund Transfer terminal capable of handling cash deposits, transfer between accounts, balance enquiries, cash withdrawals and pay bills. It may be online or offline.

The online ATM enables the customer to avail banking facilities from anywhere. In offline, the facilities are confined to that particular ATM assigned. Any customer possessing ATM card issued by the Shared Payment Network System can g< > to any ATM linked to Shared Payment Networks and perform his transactions.

5. Define Credit Allocation.

Ans :

Meaning

The credit which a bank offers for specific sector of the economy such as small business, farming, services, residential real estate, women entrepreneurs and so on is known as credit allocation. Governments usually encourage banks to extend credit to significant sectors of the economy by offering special subsidies. It allows banks to service credit needs of such sectors without impacting their competitiveness or profitability.

6. Define branch banking.

Ans :

Under the branch banking system, a single commercial bank is a very big institution which spreads its branches across different geographic areas of the country. Branch banking is also known as "Delocalized Banking", as it allows the opening of a number of branches for performing the banking operations.

Branch banking system is quite famous in India.

The following are few Indian banks which follow branch banking system: State Bank of India (SBI), SBH, HDFC, ICICI, Yes Bank and so on.

These banks provide a variety of services such as, accepting deposits and cash withdrawals from a demand account with a bank teller, provide financial advice, insurance sales and so on.

7. Define Unit Banking.

Ans :

Meaning

An independent unit bank is a corporation that operates one office and that is related to other banks through either ownership or control".

Under this type of banking system, the banking operations are usually subjected to merely a single office or in certain cases to some offices in the restricted local areas. Usually, unit banks provide services through a single bank and do not have any branches. Under the unit banking system, different units of banks perform their functions independently. It is also called as "localised banking".

It is quite popular in USA where different unit banks are clubbed together through a "correspondent banking system" which has the benefits of branch banking.

8. Define Group Banking.

Ans :

Meaning

Group Banking is that banking system in which two or more banks operate under the control of a holding company. Under group banking two or more banks are brought under the control of the same management through a holding company.

"Group Banking refers to the system in which a corporation or a holding company operates two or more banks simultaneously".-Goldfield and Chandler

Under group banking, a holding company controls and manages the functioning of its subsidiaries banks. There can be more than one bank under the control and management of the holding company. The holding company is popularly known as parent company and the group of banks operating under holding company is called operating companies or subsidiary companies.

9. Define Micro Finance.

Ans :

Meaning

Microfinance refers to the provision of financial services to low-income clients, including consumers and the self-employed. The term also refers to the practice of sustainably delivering those services. Microcredit (or loans to poor micro enterprises) should not be confused with microfinance, which addresses a full range of banking needs for poor people.

It refers to a movement that envisions "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 transfers." Those who promote microfinance generally believe that such access will help poor people out of poverty.

1. Better Loan Repayment Rates

Microfinance tends to target women borrowers, who are statistically less likely to default on their loans than men. So these loans help empower women, and they are often safer investments for those loaning the funds.

2. Extending Education

Families receiving micro financing are less likely to pull their children out of school for economic reasons.

10. Plastic Money

Ans :

Plastic money refers to the replacement of currency notes into plastic cards. These plastic cards used in place of currency is known as the plastic money.

Plastic money's main objective is to ensure user's safety eliminating the risk of carrying cash. The postponement of actual payment or pre-purchase payment on the card issued are some of the other several objectives of plastic money.

11. EFT

Ans :

Electronic Fund Transfer (EFT) is defined as a process of transferring funds electronically from one financial institution to another. This type of electronic transfer started using different electronic devices like computers, telephone devices, electronic terminals, telecommunications devices. This transfer is done for ordering, instructing and authorizing a bank to debit/ credit an account.

Electronic fund transfer is different from traditional methods of payment that depends on physical delivery of cash by using physical means of transport.

12. Digital Cash

Ans :

Digital Cash or Electronic cash is a form of electronic payment system which provides high level of security and reduces the overhead of paper cash. Because of its adaptable and flexible nature, it opened a way for new markets and applications.

It enables the merchants to think beyond the local markets. The merchants can now attract global customers because they can send and receive money throughout the world with just a mouse-click on their desktop. The currency limitations of a particular country can also be eliminated because, E-cash can be filed into and withdrawn from a smart card from anywhere and in any currency. It is also difficult to forge (duplicate) electronic cash than physical currency.

13. What is E-banking?

Ans :

Introduction

The banking industry is now a very mature one and banks are being forced to change rapidly as a result of open market forces such as threat of competition, customer demand, and technological innovations such as growth of internet banking. If banks have to retain their competitiveness, they must focus on customer retention and relationship management, upgrade and offer integration and value added services. With the increasing customer demands, banks have to constantly think of innovative customized services to remain competitive. That's why internet banking is becoming a necessity today.

Meaning

Electronic banking (E-banking) is a generic term encompassing internet banking, telephone banking, mobile banking etc. In other words, it is a process of delivery of banking services and products through electronic channels such as telephone, internet, cell phone etc. The concept and scope of E-banking is still evolving.

Electronic services allow a bank's customers and other stakeholders to interact and transact with the bank seamlessly through a variety of channels such as the internet, wireless devices, ATMs, on-line banking, phone banking and telebanking. Other services offered under E-banking include electronic fund transfer, electronic clearing service and electronic payment media including the credit card, debit card and smart card. On-line banking helps consumers to overcome the limitations of place and time as they can bank anywhere, anytime as these services are available twenty four hours, 365 days a year without any physical limitations of space like a specific bank branch, city or region. They also bypass the paper based aspect of traditional banking.

14. Define Credit Card

Ans :

Meaning

A credit card is part of a system of payments named after the small plastic card issued to users of the system. It is a card entitling its holder to buy goods and services based on the holder's promise to pay for these goods and services. The issuer of the card grants a line of credit to the consumer (or the user) from which the user can borrow money for payment to a merchant or as a cash advance to the user.

A credit card is different from a charge card, where a charge card requires the balance to be paid in full each month. In contrast, credit cards allow the consumers to 'revolve' their balance, at the cost of having interest charged. Most credit cards are issued by local banks or credit unions,

As well as convenient, accessible credit, credit cards offer consumers an easy way to track expenses, which is necessary for both monitoring personal expenditures and the tracking of work-related expenses for taxation and reimbursement purposes. Credit cards are accepted worldwide, and are available with a large variety of credit limits, repayment arrangement, and other perks.

15. Define Foreign Banks.

Ans :

Foreign banks are those banks which are registered or incorporated outside India, and having a branch in India. These banks are also controlled and supervised by RBI. At present the Reserve Bank of India has allowed the foreign banks to establish the banking business in India through a single mode of presence i.e. either branch mode or a wholly owned subsidiary mode. The number of foreign banks have increased in India with the changes in the banking policy after 1993.

Some of the foreign banks having a work place in India are listed below :

1. HSBC
2. Standard Chartered Bank
3. Citibank
4. Bank of America

16. Co-operative banks.

Ans :

According to section 2(iv) of Maharashtra Co-operative Societies Act, I960, “Co-operative bank is a society which is doing the business oi banking”. Co-operative banks are the financial or banking institutions which are established on the basis of co-operative principles and engaged in banking transactions like accepting deposits from public with a purpose to lend that deposits to others. Co-operative banks are voluntary organizations which open for all persons who are interested to use the services willingly and also ready to the responsibilities of membership without any discrimination of gender, caste, religion etc.

Choose the Correct Answers

1. Fluctuations in the market price of equity results in ________. [d]
   (a) Foreign risk (b) Basis risk
   (c) Market risk (d) Equity price risk

2. ________ is defined as a process of transferring funds electronically from one financial institution to another. [a]
   (a) EFT (b) RTGS
   (c) ECS (d) All

3. E-cash is one of the ________ payment system. [c]
   (a) Credit-card based (b) debit card
   (c) Token-based (d) Smart card

4. The following reason, increase in cut-throat competition, market expansion and reduction in the costs of products resulted in the generation of ________. [a]
   (a) Core banking solution (b) Retail banking
   (c) Basel committee (d) Bank capital

5. ________ is a retail payment system enables to make bulk payments and bulk receipts. [a]
   (a) Electronic Clearing Services [ECS] (b) Electronic payment system
   (c) RFID (d) All

6. What is the MSME Public Procurement Portal called? [b]
   (a) MSME Samjhauta (b) MSME Sambandh
   (c) MSME Sandesh (d) MSME Sampark

7. For whom was a radio jingle released by MSME ministry on 20th Sept 2017? [ ]
   (a) National SC ST Hub (b) Marginalized communities
   (c) Minority communities (d) Both a and c

8. India on 13th Dec 2016 signed an agreement for MSME financing with which bank? [a]
   (a) IBRD (b) WB
   (c) ADB (d) None of the above

9. The card by which you cannot buy a product is: [b]
   (a) Credit card (b) ATM card
   (c) Debit card (d) Smart card

10. PIN in ATM card id of [c]
    (a) 4 alphabets (b) 2 alphabets and 2 digits
    (c) 4 digits (d) None of the above

11. Knowing someone else password by certain illegal means is……. [a]
    (a) Hacking (b) Plagiarism
    (c) Log on script (d) Password policy
12. Which one of the following is a safety measure in banking network? [b]
    (a) Router (b) Firewall
    (c) Modem (d) None of the above
13. In credit card what is the grace period of payment? [c]
    (a) 10-15 days (b) 5-20 days
    (c) 15-45 days (d) 1-2 day
14. Who can pass the law for e-banking? [c]
    (a) SBI (b) Parliament
    (c) RBI (d) Merchant Association
15. The customer access E-banking services using: [d]
    (a) PC (b) PDA
    (c) ATM (d) All of the above

Fill in the Blanks

1. In modern economy ________ Play an important role in the financial sector.
2. ________ are also known as time deposits.
3. The second main function of the commercial bank is to ________.
4. ________ is an advance in lump sum amount the whole of which is withdrawn and is supported to be rapid generally wholly at one time.
5. An ________ is an arrangement by which the customer is allowed to overdraw his account.
6. ________ is a substitute of EFT (Electronic Fund Transfer) system.
7. Payment channel ________.
8. ________ is a form of digital cash that provides a high level of security.
9. Bank capital is consists of ________ and ________.
10. Example of Plastic money ________.
11. ________ arises due to changes in the interest-rate options.
12. EFT stands for ________.

Answers

1. Commercial Banks
2. Fixed Deposits
3. Advance loans
4. Loan
5. Overdraft
6. NEFT [National Electronic Fund Transfer]
7. ATM
8. E-cash
9. Assets and liabilities
10. Debit Card
11. Optimality risk
12. Electronic Fund Transfer

FACULTY OF MANAGEMENT

BBA VI-Semester(CBCS) Examination

November / December - 2021

BANKING AND INSURANCE SERVICES

Time : 2 Hours] [Max. Marks : 80

PART - A (4 × 5 = 20 Marks)

Note : Answer any four questions.

ANSWERS

1. What are Nationalized Banks? **(Unit-I, SQA.13)**
2. Who are Lender of last resort? **(Unit-I, SQA.1)**
3. What are Co-operative Banks? **(Unit-V, SQA.16)**
4. What is Re-Insurance? **(Out of Syllabus)**
5. What are IRDA? **(Out of Syllabus)**
6. What are MSME? **(Unit-V, SQA.1)**
7. What is the principle of Subrogation? **(Out of Syllabus)**
8. What is ATM? **(Unit-V, SQA.4)**

PART - B (4 × 15 = 60 Marks)

Note : Answer any four questions.

9. Write about the reforms in Banking Sectors. **(Unit-I, Q.No.12)**
10. Discuss the emerging role of Bankers? Explain the role of Banks in Economic Development. **(Unit-I, Q.No.10,11)**
11. Explain about Banker and Customer Relationship. **(Unit-IV, Q.No.1)**
12. What are the types and rules of Crossing? **(Unit-IV, Q.No.9)**
13. Write about the latest trends in Banking ATM, e-Banking and Mobile-Banking. **(Unit-V, Q.No.14,17,20)**
14. Write about the role played by foreign banks? Explain its advantages and disadvantages? **(Unit-V, Q.No.44,45)**
15. Write about process and functions of 1RDA. **(Out of Syllabus)**
16. Define insurance? Explain its nature, importance and functions. **(Out of Syllabus)**
17. What is general insurance? Explain the different types of general insurance? **(Out of Syllabus)**
18. What is the concept of life insurance? Explain life insurance products. **(Out of Syllabus)**

FACULTY OF MANAGEMENT

BBA VI-Semester(CBCS) Examination

July / August - 2021

BANKING AND INSURANCE SERVICES

Time : 2 Hours] [Max. Marks : 80

PART - A (4 × 5 = 20 Marks)

Note : Answer any four questions.

		Answers
1.	Commercial Bank	**(Unit-I, SQA.12)**
2.	Lender of last resort	**(Unit-I, SQA.1)**
3.	NABARD	**(Unit-II, SQA.10)**
4.	1RDA	**(Out of Syllabus)**
5.	MSMEs	**(Unit-V, SQA.1)**
6.	Co-operative Banks	**(Unit-V, SQA.16)**
7.	Types of Loans & Advances	**(Unit-IV, SQA.1,2)**
8.	Life Insurance	**(Out of Syllabus)**

PART - B (4 × 15 = 60 Marks)

Note : Answer any four questions.

9.	Write about the functions of Reserve Bank.	**(Unit-I, Q.No.9)**
10.	Explain about the role of banks in the economic development.	**(Unit-I, Q.No.11)**
11.	Explain about banker and role played by them in customer relationships.	**(Unit-IV, Q.No.1)**
12.	What are the types and rules of crossing?	**(Unit-IV, Q.No.9)**
13.	Write about different types of banks? Explain about branch banking and group banking.	**(Unit-V, Q.No.3,4,5,7)**
14.	What are the latest trends in Banking?	**(Unit-V, Q.No.13)**
15.	Explain the insurance sector reforms in India.	**(Out of Syllabus)**
16.	Write about powers and functions of 1RDA.	**(Out of Syllabus)**
17.	What is Life Insurance? Explain about tax treatement of life insurance.	**(Out of Syllabus)**
18.	What is general Insurance? Explain the different types of General Insurance.	**(Out of Syllabus)**

FACULTY OF MANAGEMENT

BBA VI-Semester(CBCS) Examination

September / October - 2020

BANKING AND INSURANCE SERVICES

Time : 2 Hours] [Max. Marks : 80

PART - A (4 × 5 = 20 Marks)

Note : Answer any four questions.

		ANSWERS
1.	Definition of Banker and Customer	**(Unit-I, SQA.2, 3)**
2.	Commercial Bank	**(Unit-I, SQA.12)**
3.	Rules of Crossing Cheques	**(Unit-IV, SQA.14)**
4.	Online Banking	**(Unit-V, SQA.2)**
5.	ECS	**(Unit-V, SQA.3)**
6.	Re-insurance	**(Out of Syllabus)**
7.	Group Insurance	**(Out of Syllabus)**
8.	Pension Plans.	**(Out of Syllabus)**

PART - B (4 × 15 = 60 Marks)

Note : Answer any four questions.

9.	Describe the functions of RBI.	**(Unit-I, Q.No.9)**
10.	Explain the recent reforms in banking sector.	**(Unit-I, Q.No.12)**
11.	Explain banker and customer relationship.	**(Unit-IV, Q.No.1)**
12.	Describe the principles of sound lending.	**(Unit-IV, Q.No.15)**
13.	Discuss various types of banks.	**(Unit-V, Q.No.3)**
14.	Differentate between traditional banking and e-banking.	**(Unit-V, Q.No.38)**
15.	Explain the importance and functions of insurance.	**(Out of Syllabus)**
16.	Write a note on insurance sector reforms in India.	**(Out of Syllabus)**
17.	Explain the concept of life insurance and the procedure for issuing a policy.	**(Out of Syllabus)**
18.	Explain the types of general insurance.	**(Out of Syllabus)**

FACULTY OF MANAGEMENT

BBA VI-Semester(CBCS) Examination

May - 2019

BANKING AND INSURANCE SERVICES

Time : 3 Hours] [Max. Marks : 80

PART - A (5 × 4 = 20 Marks)

[Short Answer Type]

Note : Answer all questions following.

ANSWERS

1. Answer any five of the following questions.

   (a) Lender of Last Resort. **(Unit-I, SQA.1)**

   (b) What are Nationalized Banks? **(Unit-I, SQA.13)**

   (c) What are the types of loans and advances? **(Unit-IV, SQA.1, 2)**

   (d) What are Cooperative Banks? **(Unit-V, SQA.16)**

   (e) What are MSME's? **(Unit-V, SQA.1)**

   (f) What is Re-Insurance? **(Out of Syllabus)**

   (g) What is IRDA? **(Out of Syllabus)**

   (h) The Principle of Subrogation. **(Out of Syllabus)**

PART - B (5 × 12 = 60 Marks)

[Essay Answer Type]

Note : Answer all the questions using the internal choice.

2. (a) What are the emerging role of Bankers? Explain the role of Banks in economic development. **(Unit-I, Q.No.10,11)**

   (OR)

   (b) Explain the reforms in Banking Sector. **(Unit-I, Q.No.12)**

3. (a) What are the types and rules of crossing? **(Unit-IV, Q.No.9)**

   (OR)

   (b) What is Banker and Customer Relationship? **(Unit-IV, Q.No.1)**

4. (a) What are the latest trends in Banking ATM, E-Banking and Mobile Banking. **(Unit-V, Q.No.14,17,20)**

   (OR)

   (b) What is the role of Foreign Banks? Explain its advantages and disadvantages. **(Unit-V, Q.No.43,45)**

5. (a) Define Nature of Insurance. Explain its importance and functions. **(Out of Syllabus)**

(OR)

(b) Explain Globalization of Insurance and Insurance Sector Reforms in India. **(Out of Syllabus)**

6. (a) What is the concept of life insurance? Explain life insurance products. **(Out of Syllabus)**

(OR)

(b) What are general insurance types? Explain health, accident, motor and fire insurance. **(Out of Syllabus)**

FACULTY OF MANAGEMENT

B.B.A III Year VI-Semester(CBCS) Examination

MODEL PAPER - I

BANKING

Time: 3 Hours	Max. Marks : 80

PART – A (5 × 4 = 20 Marks)
(Short Answer Type)

Note: Answer all the questions.

ANSWERS

1. Answer any five of the following in not exceeding 20 lines each.

(a) Agency Services **(Unit-I, SQA-6)**

(b) Lender of the Last Resort **(Unit-I, SQA-1)**

(c) Define Monetary Policy. **(Unit-II, SQA-2)**

(d) IDBI **(Unit-II, SQA-12)**

(e) Define Negotiable Instruments. **(Unit-III, SQA-1)**

(f) Bill of Exchange **(Unit-III, SQA-4)**

(g) General relationship between banker and customer. **(Unit-IV, SQA-3)**

(h) Define Credit Allocation. **(Unit-V, SQA-5)**

PART – B (5 × 12 = 60 Marks)

(Essay Answer Type)

Note: Answer the following questions in not exceeding four pages each, using the internal choice.

2. (a) Explain in detail primary functions of Commercial Banks. **(Unit-I, Q.No.6)**

OR

(b) Explain the major recommendations of Narasimham committee on review of financial sector reforms 1998. **(Unit-I, Q.No.12)**

3. (a) Define NABARD. Explain the functions of NABARD. **(Unit-II, Q.No.19)**

OR

(b) Explain various types of development banks. **(Unit-II, Q.No.30)**

4. (a) State the characteristic features of Negotiable Instruments? **(Unit-III, Q.No.2)**

OR

(b) Discuss the Circumstances in which a banker should refuse the payment cheques. **(Unit-III, Q.No.18)**

5. (a) Explain briefly the special relationship between banker and customer. **(Unit-IV, Q.No.1)**

OR

(b) What is Endorsements. Explain the essentials of a valid Endorsement. **(Unit-IV, Q.No.11)**

6. (a) What is mobile banking? Explain various Technologies Enabling Mobile Banking. **(Unit-V, Q.No.20)**

OR

(b) What do you mean by Micro Small and Medium Enterprise (MSME)? Outline the recent performance of the MSME sector. **(Unit-V, Q.No.39)**

FACULTY OF MANAGEMENT

B.B.A III Year VI-Semester(CBCS) Examination

MODEL PAPER - II

BANKING

Time: 3 Hours Max. Marks : 80

PART – A (5 × 4 = 20 Marks)
(Short Answer Type)

Note: Answer all the questions.

ANSWERS

1. Answer any five of the following in not exceeding 20 lines each.

(a) Define the term banker. **(Unit-I, SQA-2)**

(b) What are Nationalized Banks. **(Unit-I, SQA-13)**

(c) Development Banks. **(Unit-II, SQA-14)**

(d) Regional Rural Banks. **(Unit-II, SQA-7)**

(e) Cheque **(Unit-III, SQA-5)**

(f) Define paying banker. **(Unit-III, SQA-9)**

(g) Special relationship between banker and customer. **(Unit-IV, SQA-4)**

(h) Co-operative banks. **(Unit-V, SQA-16)**

PART – B (5 × 12 = 60 Marks)
(Essay Answer Type)

Note: Answer the following questions in not exceeding four pages each, using the internal choice.

2. (a) Explain the concept of Emerging Role of Bankers. **(Unit-I, Q.No.10)**

OR

(b) What do you mean by Global Financial Crisis? Explain the main causes of GFC. **(Unit-I, Q.No.13)**

3. (a) Explain the various suggestions to improve the working of RRB's. **(Unit-II, Q.No.18)**

OR

(b) Explain different tools of Monetary Policy? **(Unit-II, Q.No.7)**

4. (a) Discuss the Consequences of Wrongful Dishonour of Cheques. **(Unit-III, Q.No.19)**

OR

(b) Define collecting banker. State the duties and responsibilities of a collecting banker. **(Unit-III, Q.No.16)**

5. (a) Explain various types of crossing cheques. **(Unit-IV, Q.No.9)**

OR

(b) Discuss the procedure to open a bank account. **(Unit-IV, Q.No.4)**

6. (a) Explain the Advantages & Disadvan-tages of Foreign Banks **(Unit-V, Q.No.45)**

OR

(b) What is E-banking? and Explain the advantages and disadvantages in E-banking. **(Unit-V, Q.No.17)**

FACULTY OF MANAGEMENT

B.B.A III Year VI-Semester(CBCS) Examination

MODEL PAPER - III

BANKING

Time: 3 Hours Max. Marks : 80

PART – A (5 × 4 = 20 Marks)
(Short Answer Type)

Note: Answer all the questions.

ANSWERS

1. Answer any five of the following in not exceeding 20 lines each.

(a) Commercial Bank **(Unit-I, SQA-12)**

(b) Advancing Loans **(Unit-I, SQA-5)**

(c) What is District Central Cooperative Bank (DCCB)? **(Unit-II, SQA-6)**

(d) SIDBI **(Unit-II, SQA-13)**

(e) Compare and contrast Promissory note and bill of exchange. **(Unit-III, SQA-8)**

(f) Define collecting banker. **(Unit-III, SQA-10)**

(g) Rules of crossing. **(Unit-IV, SQA-14)**

(h) ECS. **(Unit-V, SQA-3)**

PART – B (5 × 12 = 60 Marks)
(Essay Answer Type)

Note: Answer the following questions in not exceeding four pages each, using the internal choice.

2. (a) Describe the functions of reserve bank of India (RBI). **(Unit-I, Q.No.9)**

OR

(b) Explain the Role of Banks in Economic Development. **(Unit-I, Q.No.11)**

3. (a) What is SIDBI? Discuss the objectives and functions of SIDBI ? **(Unit-II, Q.No.26)**

OR

(b) What is RBI ? Explain the organizational structure of RBI. **(Unit-II, Q.No.1)**

4. (a) What is meant by Bill of Exchange? State the characteristics of Bill of Exchange. **(Unit-III, Q.No.8)**

OR

(b) State different types of collateral securities. Explain various precautions while advances against them. **(Unit-III, Q.No.26)**

5. (a) Explain the rules of endorsements. **(Unit-IV, Q.No.13)**

OR

(b) Briefly describe the principles of sound lending. **(Unit-IV, Q.No.15)**

6. (a) Define the term EFT. Explain the advantages and disadvantages. **(Unit-V, Q.No.34)**

OR

(b) Define branch banking. Explain the merits and demerits of branch banking. **(Unit-V, Q.No.4)**