# Syllabus

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# Module 1

## Banking system and structure in India

### Evolution of Indian Banks

- **Banking in India** originated in the last decades of the 18th century.
- The first bank was The General Bank of India, which started in 1786.
- Bank of Hindustan was the 2nd bank, which started in 1790; both are now defunct.
- The oldest bank in existence in India is the State Bank of India, which originated in the Bank of Calcutta in June 1806, which almost immediately became the Bank of Bengal.
- The period between 1906 and 1911, saw the establishment of banks inspired by the Swadeshi movement. A number of banks established then have survived to the present such as Bank of India, Corporation Bank, Indian Bank, Bank of Baroda, Canara Bank and Central Bank of India.
- During the First World War (1914–1918) through the end of the Second World War (1939–1945), and two years thereafter until the independence of India were challenging for Indian banking.

From Bank of Hindustan in 1770, the evolution of banking in India can be divided into three different periods as follows:

Phase I: Early phase of primitive Indian banks to Nationalization of Banks in 1969

Phase II: From Nationalization of India banks in 1969 up to advent of liberalization and banking reforms in 1991

Phase III: From Indian Financial and Banking Sector Reforms 1991 onward

**Post Independence**

- India observed the emergence of large number of institutions for providing finance to different sectors of the economy.
- The entry activities of private sector and foreign banks were restricted through branch licensing and regulation norms.
- Steps taken by Indian Govt. to regulate banking are:

Reserve bank of India was nationalized on January 1, 1949 under the terms of Reserve bank of India.

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- In 1949, the Banking Regulation Act was in acted.
- The Banking Regulation Act also provided that no new bank or branch of an existing bank could be opened without a license from the RBI.
- No two banks could have common directors.

**Nationalization**

- The nationalization of banks in India took place in 1969 by Mrs. Indira Gandhi. It nationalized 14 banks. Before the steps of nationalization of Indian banks, only State Bank of India (SBI) was nationalized.
- Nationalization of Seven State Banks of India (formed subsidiary) took place on 19th July, 1960.
- The second phase of nationalization of Indian banks took place in the year 1980. Seven more banks were nationalized with deposits over 200 crores.
- The stated reason for the nationalization was to give the government more control of credit delivery.

**Adoption of banking technology**

The IT revolution had a great impact in the Indian banking system:

- Introduction of online banking in India.
- Formation of committee on Mechanization in the banking Industry in 1984, providing use of standardized cheque forms and encoders.
- Formation of committee on Computerization in Banks (1988) which emphasized that settlement operation must be computerized in the clearing houses of RBI.
- Focused on computerization of branches and increasing connectivity among branches through computers.
- Formation of Committee on Technology Issues relating to Payments System, Cheque Clearing and Securities Settlement in the Banking Industry (1994) emphasized on Electronic Funds Transfer (EFT) system, with the BANKNET communications network as its carrier.
- ATMs installed in India by various banks as on end March 2005 is 17,642.

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**Types of Banks**

1. **The public sector banks** are owned and operated by the government, who has a major share in them. The major focus of these banks is to serve the people rather earn profits. Some examples of these banks include State Bank of India, Punjab National Bank, Bank of Maharashtra, etc.
2. **The regional rural banks** were brought into operation with the objective of providing credit to the rural and agricultural regions and were brought into effect in 1975 by RRB Act. These banks are restricted to operate only in the areas specified by government of India. These banks are owned by State Government and a sponsor bank. This sponsorship was to be done by a nationalized bank and a State Cooperative bank. Prathama Bank is one such example, which is located in Moradabad in U.P.
3. **The private sector banks** are owned and operated by private institutes. They are free to operate and are controlled by market forces. A greater share is held by private players and not the government. For example, Axis Bank, Kotak Mahindra Bank etc.

**Performance of public sector bank**

The financial system of any country consists of financial institutions, financial markets, financial instruments, financial services and financial assets. An efficient and a smooth financial system plays an important role in the nation's economic development. A well developed country will have a well-organized financial Institutions. Financial Institutions are an important part of the Indian Financial System. The institutions are divided into two categories, banking and non-banking. Banks play a pivotal role in India's economy. The year 1969 was a landmark in the history of commercial banking in India. In July 1969, the government nationalized 14 major commercial banks of the country. In 1980, 6 more banks were nationalized.

The first Five Year Plan held in the 1951 accorded the development of the rural areas as the highest priority. The plan was for the time period between 1951–1956. The All India Rural Credit Survey Committee advised the government to create state partnered and state owned banks. An act was passed in the parliament in May 1955 and the State

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Bank of India was constituted. Later the State Bank of India Act was passed in 1959 to take over the associate banks of SBI and its subsidiaries.

The pre-nationalization period saw a lion's share in the industrial sector to the bank's credit. Large scale industries cornered a large portion of the credit and the share of small scale industries was marginal. There were many reasons for the dominance of the large scale industries in the banking sector. Many commercial banks were under the ownership and control of big industrial houses. A disturbing feature of the pre-nationalization banking policy was the negligence of agriculture sector to the bank's credit. This share hovered around 2% of the total commercial bank credit. The privately owned commercial banks were neither interested nor geared up to meet the risky and small credit requirements of the farmers. Similarly, the share of other non-industrial sectors was also very low. Since the commercial banks were under the control of big industrialists, the loanable funds of the banks were sometimes used to finance socially undesirable activities like hoarding of essential commodities.

The post-nationalization period witnessed certain drastic changes in the economy. All the leading commercial banks of the country were nationalized in the year 1969 with some objectives in mind. The objectives of nationalization were as follows:

- To break the ownership and control of banks by a few business families.
- To prevent concentration of wealth and economic power.
- To mobilize savings of the masses from every nook and corner of the country.

To pay more attention to the priority sectors of the economy like agriculture and small scale industries, the post-nationalization period saw a remarkable expansion in the banking and financial system. The biggest achievement of nationalization was the reallocation of sectoral credit in favor of agriculture, small scale industries and exports. Within agriculture, credit for the procurement of food grains, i.e., food credit was a major thing. Other agriculture activities included poultry farming, dairy and piggery.

Certain other sectors of the economy which also received attention for credit allocation were professionals, self-employed individuals, artisans and other weaker sections of the society. Conversely, there was a sharp fall in bank credit to large scale industries. However, the share of small-scale industry registered an upward trend. Nationalization

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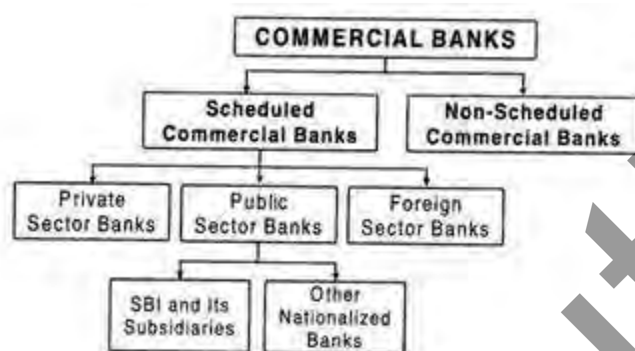
of commercial banks had many pros and cons for the economy. The government paid more attention to agriculture than industry. The country witnessed increasing numbers of bank branches in the rural areas. Branch expansion program resulted in mobilization of savings from all parts of the country.

**Commercial Banking**

A **commercial bank** is a type of **bank** that provides services such as accepting deposits, making business loans, and offering basic investment products.

**Structure of commercial bank**

***The commercial banks can be broadly classified under two heads:***




**1. Scheduled Banks:**

Scheduled Banks refer to those banks which have been included in the Second Schedule of Reserve Bank of India Act, 1934.

**In India, scheduled commercial banks are of three types:**

**(i) Public Sector Banks**:

These banks are owned and controlled by the government. The main objective of these banks is to provide service to the society, not to make profits. State Bank of India, Bank of India, Punjab National Bank, Canada Bank and Corporation Bank are some examples of public sector banks.

Public sector banks are of two types:

(a) SBI and its subsidiaries;

(b) Other nationalized banks.

**(ii) Private Sector Banks:**

These banks are owned and controlled by private businessmen. Their main objective is to earn profits. ICICI Bank, HDFC Bank, IDBI Bank is some examples of private sector banks.

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**(iii) Foreign Banks**:

These banks are owned and controlled by foreign promoters. Their number has grown rapidly since 1991, when the process of economic liberalization had started in India. Bank of America, American Express Bank, Standard Chartered Bank are examples of foreign banks.

**2. Non-Scheduled Banks:**

Non-Scheduled banks refer to those banks which are not included in the Second Schedule of Reserve Bank of India Act, 1934.

**Functions of commercial banks**

1. Primary or Principle functions
2. Secondary or Subsidiary function

**1. Primary or Principle functions**

- Receiving deposits

Accepting various types of deposits is an important function of the commercial banks. Deposits constitute the main sources of the funds for commercial banks. Deposits are of various types like demand deposits, savings deposits and fixed deposits.

a) Demand deposits

Demand deposits also known as current deposits are those which can be withdrawn by the depositor at any time by means of cheques. The bank does not pay any interest on demand deposits. In fact, a bank makes a small charge on the customers with a current account. It is convenient for businessmen to pay creditors by drawing cheques and also get the cheques received by them collected.

b) Savings deposits

Savings deposits are those deposits on which a bank pays a certain percentage of interest to the depositors but the bank places certain restrictions on their withdrawals. For instance, today in India only 150 withdrawals in a year are allowed by the banks. Further the total amount withdrawals that can be made is restricted to Rs.20, 000. Or 10% of the credit balance in the customer's accounts whichever is greater. A proper and satisfactory introduction is necessary to open savings bank account. These accounts are meant for encouraging thrift and a habit of savings among the people.

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c) Fixed deposits

There are deposits which can be withdrawn after the expiry of a specified fixed period these are also called time deposits. The rate of interest is higher than that allowed on savings deposit. The fixed deposits are withdrawn by surrendering the fixed deposit receipts, obtained from the bank at the time of depositing the money.

- Lending of funds

The bank lends fund by means of loans, overdrafts, cash credits and discounting of bills.

a) Loan

Loan is financial accommodation under which bank grants an advance on a separate account called loan account. Interest is charged on the entire amount of loan sanctioned. Loans are given to all types of persons against the personal security of the borrower or against the personal movable or immovable properties.

b) Overdraft

An overdraft is a financial accommodation under which a current account holder is permitted to overdraw his account upto an agreed limit. Interest is charged on the exact amount overdrawn by the customer. It is granted against the security of the borrower. It is advantageous to the borrower because interest is charged only on the amount actually overdrawn by him.

c) Cash credit

A cash credit is a financial accommodation under which an advance is granted on a separate account called cash credit account upto a specified limit. Interest is charged on the amount made use of by the borrower. It is granted against the security of goods or personal security of one or more persons other than the borrower. Traders prefer cash credit to direct loans as they need not pay interest on the entire amount.

d) Discounting of bills

Discounting of bills is a financial arrangement under which a customer holding a bill of exchange can get a loan equivalent to the value of the bill, less discount. The discount represents interest on the money lent for the unexpired period of the bill. On maturity, the banker collects the proceeds of the bill from its acceptor.

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- Investment of funds on securities

Investment of funds in securities is one of the important functions of commercial banks; they invest a considerable amount of their funds in Government and industrial securities.

**2. Secondary or subsidiary Functions**

The secondary or subsidiary functions of a bank can be divided into two classes, viz

a) Agency service

Agency services are those services which are rendered by the bank as an agent of their customer. They are:

- Collection of cheques, drafts, etc. on behalf of the customer.
- Payment of bills of exchange, life insurance premium etc., on behalf of the customer.
- Purchase and sale of securities on behalf of the customer.
- Arranging for transfer of money from one place to another on behalf of the customer.
- Acting as a trustee, executors, administrators and attorney.
- Acting as correspondents of other banks and financial institutions.
- Banks also issue credit cards to their customers.

b) General utility services

These are the services rendered not only to the customers but also to the general public as well.

- Accepting valuables and securities for safe custody
- Providing foreign exchange to the importers and exporters.
- Issuing of travelers cheques, circular notes, etc
- Underwriting shares, debentures and Govt securities.
- Acting as referees and providing information relating to the credit worthiness of their customer.
- Collection of information useful to the customers or to the general public and their publication

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- Banker may institute scholarship endowment establish book banks for the benefit of the students, arrange exhibitions and undertake any such other activities beneficial to the community in general.

***Role of commercial banks in socio economic development***

***Banks help in accelerating the economic growth of a country in the following ways:***

***1. Accelerating the Rate of Capital Formation:***

Commercial banks encourage the habit of thrift and mobilise the savings of people. These savings are effectively allocated among the ultimate users of funds, i.e., investors for productive investment. So, savings of people result in capital formation which forms the basis of economic development.

***2. Provision of Finance and Credit:***

Commercial banks are a very important source of finance and credit for trade and industry. The activities of commercial banks are not only confined to domestic trade and commerce, but extend to foreign trade also.

***3. Developing Entrepreneurship:***

Banks promote entrepreneurship by underwriting the shares of new and existing companies and granting assistance in promoting new ventures or financing promotional activities. Banks finance sick (loss-making) industries for making them viable units.

**4. *Promoting Balanced Regional Development:***

Commercial banks provide credit facilities to rural people by opening branches in the backward areas. The funds collected in developed regions may be channelised for investments in the under developed regions of the country. In this way, they bring about more balanced regional development.

**5. *Help to Consumers*:**

Commercial banks advance credit for purchase of durable consumer items like Vehicles, T.V., refrigerator etc., which are out of reach for some consumers due to their limited paying capacity. In this way, banks help in creating demand for such consumer goods.

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**Services rendered by commercial banks**

**1. Accepting Deposit**

Accepting deposit from savers or account holders is the primary function of bank. Banks accept deposit from those who can save money, but cannot utilize in profitable sectors.People prefer to deposit their savings in a bank because by doing so, they earn interest.

**2. Advancing Of Loans**

Banks are profit oriented business organizations. So they have to advance loan to public and generate interest from them as profit. After keeping certain cash reserves, banks provide short-term, medium-term and long-term loans to needy borrowers.

**3. Discounting of bill of exchange**

Bill of exchange is a negotiable instrument, which is accepted by the debtor, drawn upon him/her by the creditor and agrees to pay the amount mentioned on maturity. Discounting bill of exchange is another function of modern commercial bank. Under this, banks purchase bill of exchange from holder in discount after making some marginal deduction in the form of commission. The banks pay the deducted value to the holders when traders discount it into bank.

**4. Cheque Payment**

Banks provide cheque pads to the account holders. Account holders can draw cheque upon bank to pay money. Banks pay for cheques of customers after formal verification and official procedures. .

**5. Remittance**

Remittance is a system, through which cash fund is transferred from one place to another. Banks provide the facilities of remittance to the customers and earn some service charge.

**6. Collection and Payment Of Credit Instruments**

In modern business, different types of credit instruments such as bill of exchange, promissory notes, cheques etc. are used. Banks deal with such instruments. Modern banks collect and pay different types of credit instruments as the representative of the customers.

**7. Foreign Currency Exchange**

Banks deal with foreign currencies. As the requirement of customers, banks exchange foreign currencies with local currencies, which is essential to settle down the dues in the international trade.

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**8. Consultancy**

Modern commercial banks are large organizations. They can expand their function to consultancy business. In this function, banks hire financial, legal and market experts, who provide advices to customers in regarding investment, industry, trade, income, tax etc.

**9. Bank Guarantee**

Customers are provided the facility of bank guarantee by modern commercial banks. When customers have to deposit certain fund in governmental offices or courts for specific purpose, bank can present itself as the guarantee for the customer, instead of depositing fund by customers.

**Credit creation and deployment of funds**

- An important function performed by the commercial banks is the creation of credit.
- The process of banking must be considered in terms of monetary flows, that is, continuous depositing and withdrawal of cash from the bank.
- It is only this activity which has enabled the bank to manufacture money.
- Therefore the banks are not only the purveyors of money but manufacturers of money.

*Basic of Credit Creation*

The basis of credit money is the bank deposits. The bank deposits are of two kinds viz.,

(1) Primary deposits, and

(2) Derivative deposits.

Primary Deposits:

- Primary deposits arise or formed when cash or cheque is deposited by customers.
- When a person deposits money or cheque, the bank will credit his account.
- The customer is free to withdraw the amount whenever he wants by cheques.
- These deposits are called "primary deposits" or "cash deposits."
- It is out of these primary deposits that the bank makes loans and advances to its customers.
- The initiative is taken by the customers themselves. In this case, the role of the bank is passive.
- So these deposits are also called "passive deposits." These deposits merely convert currency money into deposit money. They do not create money.

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- They do not make any net addition to the stock of money. In other words, there is no increase in the supply of money.

Derivative Deposits:

- Bank deposits also arise when a loan is granted or when a bank discounts a bill or purchase government securities.
- Deposits which arise on account of granting loan or purchase of assets by a bank are called "derivative deposits."
- Since the bank play an active role in the creation of such deposits, they are also known as "active deposits."
- Thus, credit creation implies multiplication of bank deposits. Credit creation may be defined as "the expansion of bank deposits through the process of more loans and advances and investments."
    - Process of Credit Creation
- An important aspect of the credit creating function of the commercial banks is the process of multiple-expansion of credit.
- The banking system as a whole can create credit which is several times more than the original increase in the deposits of a bank.
- This process is called the multiple-expansion or multiple-creation of credit.
- Similarly, if there is withdrawal from any one bank, it leads to the process of multiple-contraction of credit.

The process of multiple credit-expansion can be illustrated by assuming:

a) The existence of a number of banks, SBI, BARODA, AXIS etc., each with different sets of depositors.

b) Every bank has to keep 20% of cash reserves, according to law, and,

c) A new deposit of Rs. 1,000 has been made with SBI to start with.

*Limitation on Credit Creation*

The commercial banks do not have unlimited power of credit creation. Their power to create credit is limited by the following factors:

1) Amount of Cash Cash

2) Reserve Ratio

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3) Banking Habits of the People

4) Nature of Business Conditions in the Economy

5) Leakages in Credit-Creation

6) Sound Securities

7) Liquidity Preference

8) Monetary Policy of the Central Bank

**Role of RBI as a regulator**

The central bank of the country is the Reserve bank of India( RBI). It was established in April 1935 with a share capital of Rs.5 crores on the basis of the recommendations of the Hilton young Commission. The share capital was divided into shares of Rs.100 each fully paid which was entirely owned by private shareholders in the beginning. The Govt held shares of nominal value of Rs.2, 20,000.

RBI was nationalized in the year 1949. The general superintendence and direction of the bank is entrusted to central Board of Directors of 20 members, the Governor and four deputy Governors, one Govt official from the Ministry of finance, ten nominated Directors by the central Govt to represent the four local Boards with the headquarters at Mumbai, Kolkata, Chennai and New Delhi. Local Boards consists of five members each central Govt appointed for a team of four years to represent territorial and economic interests and the interests of co-operative and indigenous banks.

The Reserve Bank of India Act 1934 was commenced on April1, 1935. The Act, 1934 (II of 1934) provides the statutory basis of the functioning of the bank.

The bank was constituted for the need of following:

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

**Role of GOI as a regulator of Banking System**

**Bank regulations** are a form of government regulation which subject banks to certain requirements, restrictions and guidelines. This regulatory structure creates transparency between banking institutions and the individuals and corporations with whom they conduct business, among other things.

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Given the interconnectedness of the banking industry and the reliance that the national (and global) economy hold on banks, it is important for regulatory agencies to maintain control over the standardized practices of these institutions. Supporters of such regulation often hinge their arguments on the "too big to fail" notion. This holds that many financial institutions (particularly investment banks with a commercial arm) hold too much control over the economy to fail without enormous consequences. This is the premise for government bailouts, in which government financial assistance is provided to banks or other financial institutions who appear to be on the brink of collapse. The belief is that without this aid, the crippled banks would not only become bankrupt, but would create rippling effects throughout the economy leading to systemic failure.

**Objectives of bank regulation**

Objectives of bank regulation, and the emphasis, vary between jurisdictions. The most common objectives are:

1. Prudential—to reduce the level of risk to which bank creditors are exposed (i.e. to protect depositors)
2. Systemic risk reduction—to reduce the risk of disruption resulting from adverse trading conditions for banks causing multiple or major bank failures
3. Avoid misuse of banks—to reduce the risk of banks being used for criminal purposes, e.g. laundering the proceeds of crime
4. To protect banking confidentiality
5. Credit allocation—to direct credit to favored sectors
6. It may also include rules about treating customers fairly and having corporate social responsibility (CSR)

***General principles of Bank regulation***

- Minimum requirements

  Requirements are imposed on banks in order to promote the objectives of the regulator. Often, these requirements are closely tied to the level of risk exposure for a certain sector of the bank. The most important minimum requirement in banking regulation is maintaining minimum capital ratios. To some extent, U.S. banks have some leeway in determining who will supervise and regulate them.

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- Supervisory review

  Banks are required to be issued with a bank license by the regulator in order to carry on business as a bank, and the regulator supervises licensed banks for compliance with the requirements and responds to breaches of the requirements through obtaining undertakings, giving directions, imposing penalties or revoking the bank's license.
- Market discipline

  The regulator requires banks to publicly disclose financial and other information, and depositors and other creditors are able to use this information to assess the level of risk and to make investment decisions. As a result of this, the bank is subject to market discipline and the regulator can also use market pricing information as an indicator of the bank's financial health.

**Provisions of Banking Regulation Act and Reserve Bank of India Act**

| S. No. | Parts | Topics | Sections covered |
|---|---|---|---|
| 1. | I | Preliminary | 1 to 5A |
| 2. | II | Business of Banking Companies | 6 to 36 A |
| 3. | IIA | Control over management | 36AA to 36AC |
| 4. | IIB | Prohibition of certain activities in relation to banking Companies | 36AD |
| 5. | IIC | Acquisition of the undertakings of Banking Companies in certain cases | 36AE to 36AJ |
| 6. | III | Suspension of business and winding up of Banking Companies | 36B to 45 |
| 7. | IIIA | Speedy provision for speedy disposal of winding up proceedings | 45A to 45X |
| 8. | IIIB | Provision relating to certain operation of Banking Companies | 45Y to 45ZF |
| 9. | IV | Miscellaneous | 46 to 55A |
| 10. | V | Application of the Act to cooperative Banks | 56 |

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*Applicability of the Banking Regulation Act, 1949*

This Act applies to following categories of Banks:

- Nationalized Banks
- Non-Nationalized Banks
- Cooperative Banks

Business of banking Companies - Section 6(1) and 6(2) r.w. 56(b)

- Borrowing, raising or taking of money
- Giving advance
- Bills business
- L/C , Bank Guarantee, Indemnity
- Foreign exchange
- Providing safe deposit vaults
- Collecting and transmitting money
- Managing, selling and realizing any property that may come into the possession of the bank in satisfaction or part satisfaction of any of its dues
- Acquiring, holding and dealing with any property or any right, title or interest in any such property that may form the security or part of the security for any loans or advances or which may be connected with such security
- Undertaking and executing trusts
- Acquiring, constructing, maintaining and altering of any building for the purpose of the bank
- Acquiring and undertaking the whole or part of the business of any person or bank / company if its nature of business is as per the allowed business for the bank
- Doing all such other things as are incidental or conducive to the promotion or advancement of the business of the bank
- Any other business the Central Govt. may by notification specify as a allowed business
- Banks are prohibited to do any other business

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Cash Reserve (CRR) – Section 18 r. w. 56 (j)

- Every bank is required to keep cash reserve, with itself or by way of balance in the current account with RBI or Central / District Co-operative Bank or net balance in all such way, of minimum prescribed % amount of its DTL as of last Friday of fortnight
- A return about this has to be submitted to RBI before 15thof each month about alternate Friday

Statutory Liquidity Ratio

- Bank shall maintain unencumbered approved securities, valued not exceeding the current market price, or an amount which shall not be less than 24% of the total of its demand and time liabilities (DTL)

**Restrictions on loans and advances**

- (1) Notwithstanding anything to the contrary contained in section 77 of the Companies Act, 1956 (1 of 1956), no banking company shall,
- (a) grant any loans or advances on the security of its own shares, or
- (b) enter into any commitment for granting any loan or advance to or on behalf of
- (i) any of its directors,
- (ii) any firm in which any of its directors is interested as partner, manager, employee or guarantor, or
- (iii) any company [not being a subsidiary of the banking company or a company registered under section 25 of the Companies Act, 1956 (1 of 1956), or a Government company] of which 61[or the subsidiary or the holding company of which] any of the directors of the banking company is a director, managing agent, manager, employee or guarantor or in which he holds substantial interest, or
- (iv) Any individual in respect of whom any of its directors is a partner or guarantor.

**Licensing of banking companies**

- Save as hereinafter provided, no company shall carry on banking business in India unless it holds a license issued in that behalf by the Reserve Bank and any such license may be issued subject of such conditions as the Reserve Bank may think fit to impose.]
- Every banking company in existence on the commencement of this Act, before the expiry of six months from such commencement, and every other company before commencing

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banking business [in India], shall apply in writing to the Reserve Bank for a license under this section.

**Power to publish information**

The Reserve Bank or the National Bank, or both, if they consider it in the public interest so to do, may publish any information obtained by them under this Act in such consolidated form as they think fit.

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# Module-2

## Banker and customer

### Types of relationship between banker and customer

1. ***General feature of the relation***

- Commencement of primary general relationship

The primary general relationship between a banker and a customer starts from the time the customer opens a bank account by depositing money.

- Contractual primary general relationship

The primary general relationship between a banker and a customer arises from a contract between the two. So, it is a contractual relationship. As it is a contractual relationship, it is governed by the various terms of agreement between the two parties.

- Nature of primary general relationship

When a banker receives deposits of money from a customer, he is neither a bailee nor a trustee nor an agent, but only a debtor of the customer. This view has been endorsed by several authorities on banking law and also confirmed by many court decisions.

- Not a bailee or depositors of customer's money

A banker is not a bailee or depositary of customer's money. This is because a bailee accepts the bailment of certain things on the condition that the things bailed will not be utilized by him and the identical things will be returned. But a banker doesn't accept the money from the customer on the condition that the money deposited with him will not be utilized by him and that the identical money (i.e. the same currency notes or coins deposited with him by the customer) will be returned.

- Not a trustee of customer's money

A banker is not a trustee of the customer's money. This is because a trustee is required to use the trust money in accordance with the trust deed, render an account to the beneficiary for everything he does with the money and is bound to handover the profits earned from the use of trust money to the beneficiary. But a banker is not bound to employ the customer's money in accordance with the terms of any trust deed is not required to render an account to the customer for everything he does with the money and is not the use of the customer's money.

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- Not an agent in respect of customer's money

When a banker accepts deposits of money from a customer, he is not an agent of the customer. This is because an agent is bound to act according to the instructions of the principal, while investing the principal's money, render a detailed account for everything he does with the principal's money to the principal and is required to handover to the principal the incomes he earns from the use of principal's money.

- Only a debtor in respect of customer's money

The banker is just a debtor and the customer is a creditor when he accepts and has the deposits of the customer. Of course, in case the customer's account is overdrawn or the customer has taken loan or any other form of financial accommodation from the banker, the customer becomes the debtor and the banker becomes the creditor. So, one can conclude that the primary relationship between a banker and a customer is that of a debtor and a creditor and their respective positions are determined by the existing state of the bank account.

***Subsidiary feature of the relationship***

- Bailee and bailer relationship

When a banker accepts valuable and documents form a customer for safe custody, he becomes a bailee and the customer becomes a bailer.

As a bailee, the banker owes some duties and liabilities to the customer. They are:

a) He is required to safeguard the safe custody deposits of the customer in his hands with reasonable care.
b) It he fails to take reasonable care in the preservation of the safe custody deposits and the customers suffers loss as a consequence; he becomes liable to compensate the customer for the loss.
   In this context, it should be noted that the banker is liable only for the losses arising out of his negligence and not for those losses arising out of reasons beyond his control, such as fire, burglary, etc. this is because, a banker is only a bailee and not an insurer of the safe custody deposits left with him.
c) He is required to handover the safe custody deposits to the depositor, whenever he demands them back.

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- Trustee and beneficiary relationship

A banker becomes the trustee of his customer, when he is entrusted with some trust work. For instance, when a customer deposits a certain sum of money with the banker with specific instructions to use the same for a specific purpose, the bankers becomes the trustee of the customer in respect of that money until that purpose is fulfilled.

- Agent and principal relationship

When a banker undertakes agency services such as collection cheques, drafts & bills, collection of interest and dividends on securities, payment of premium and subscriptions, purchase and sale of securities, etc, for a customer, he becomes the agent and the customer becomes the principal.

- As an agent the banker owes some duties to the customer they are:
- He is required to act in accordance with the instruction of the principal, i.e. the customer.

He is bound to return to the customer all the incomes which he earns as an agents of the customer.

**Banker's obligation to customers**

1. Obligation to honor his customer's cheques
2. Obligation to maintain the secrecy of the customer's account
3. Interest rate related complaints.

Banks responsibility

- ➢ Explain these in writing: give examples
  - ✓ How is interest calculated?
  - ✓ Fixed interest- what is the reset clause?
  - ✓ Floating rate- what is the benchmark used?
- ➢ Clearly state terms/ conditions in loan document.

Customer's responsibility

- ✓ Read before you sign
- ✓ Do not ignore your doubts-get them clarified
- ✓ Never sign in blank document

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4. Service charges

   Bank's responsibility

   - ✓ Display service charges
   - ✓ Extend concessional rates to special category persons
   - ✓ Have a cap on all charges including interest rate and panel charges
   - ✓ Inform customers of changes; offer option to discontinue facility

   Customer's responsibility

   - ➢ Read all the material sent to you by the bank
   - ➢ Remember
     - ✓ Banks have freedom to set interest rates/ service charges
     - ✓ You have option to choose the bank which offers best rate.
     - ➢ Compare rates-make informed choice.

5. Loan documents, return of securities

   Bank's responsibility

   - ✓ Give customer a complete set of loan agreements and enclosures at time of sanction/disbursement.
   - ✓ Return the securities as soon as the loan is repaid.

   Customer's obligation

   - ✓ Get a complete set of loan documents from banker
   - ✓ Read the MITC (Most Important Terms and Conditions)
   - ✓ Get securities back as soon as loan is repaid.

6. Recovery of bank dues

   Banks responsibility

   - ✓ Place list of recovery agent on website
   - ✓ Ensure recovery agents follow code of conduct
   - ✓ Record all conversations with customers

   Customer responsibility

   - ➢ Remember
   - ✓ All loans have to be repaid
   - ✓ Not to borrow beyond your repaying capability

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- ✓ Conversation you have recovery agent is recorded.
- ➢ Seek assistance of your bank if in problem.

7. Credit cards

   Banks responsibility

   - ✓ Do not issue unsolicited cards-if activated and charged. Pay prescribed compensation without demur.
   - ✓ Do not issue unsolicited products on cards
   - ✓ Delivery of cards and PINs only to person concerned
   - ✓ Stop lost cards immediately on report of loss.
   - ✓ Consider insurance on lost cards
   - ✓ Send statements on time; use e-statements, SMS alerts, etc to keep the card holder informed of payments, due dates, etc.

   Customer's responsibility

   - ✓ Keep your credit card safely
   - ✓ Be present when card is used by merchant banker
   - ✓ Do not use public computers for internet purchase through credit cards
   - ✓ Keep credit card number and help line detail in hand
   - ✓ Report immediately if you loss card the card
   - ✓ If you don't want a card, cut it and send it back to the credit card issuing authority.

8. ATMs

   Banks responsibility

   - ✓ Ensure ATMs are in working mode at all time
   - ✓ Have CCTV in all ATMs
   - ✓ Check audit trails periodically
   - ✓ Check cash handling processes and procedures
   - ✓ Check for quality of notes stacked in the ATMs.

   Customer's responsibility

   - ✓ Keep ATM cards safely
   - ✓ Don't keep the PIN with the card

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- ✓ Inform discrepancy immediately if possible with the witness of the security guard.

9. Cheque drop facility

   Banks responsibility

   - ✓ Remember-cheque drop facility is only an alternate mode of cheque collection.
   - ✓ Box should bear legend indication that it is an alternate mode and that customer can get acknowledgement if required.
   - ✓ Install automatic cheque acknowledging machines which give receipt of dropping the cheque.

   Customer's responsibility

   - ✓ Insists and obtain acknowledgement for cheques if you want them

10. Cheque collection

    Bank's responsibility

    - ✓ Display bank's cheque collection policy
    - ✓ Adhere to the displayed policy
    - ✓ Levy charges as per RBI stipulations
    - ✓ Compensate customer without waiting for request for any delay

    Customer's responsibility

    - ✓ Read the cheque collection policy
    - ✓ Insist and obtain admissible compensation for delay.

**Right of lien**

The legal **right** of a creditor to sell the collateral property of a debtor who fails to meet the obligations of a loan contract. A **lien** exists, for example, when an individual takes out an automobile loan.

*The condition of the right are:*

1. The agent should be lawfully entitled to receive from the principal a sum of money by way of commission earned or disbursements made or services rendered in the proper execution of the business of agency.

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2. The property over which the lien to be exercised should belong to the principal and it should have been received by the agent. The property is considered to be sufficient in the possession of the agent where he has been dealing with it. Thus where an auctioneer was engaged to sell furniture at the owner's house, he was held to be sufficiently in possession to exercise lien for his commission. The property held by an agent for a special purpose implicitly excludes the right. Similarly, where possession is obtained without the principal's authority or by fraud or misrepresentation, there is no lien, briefly, the agent's possession must be lawful.

3. The agent has only a particular lien. A particular lien attached only to that specific-matter in respect of which the charges are due. No other property can be retained.

**Right of Setoff**

- Set-off means- that the bank can adjust the credit balance in a customer's account against a debit balance in another account maintained by the same customer.
- In an ongoing, situation, the right of set-off can be exercised by a banker- by serving a reasonable notice on the customer.
- The right of set-off can be exercised by the banker only when the relationship between the customer and the banker is that of- Debtor and Creditor.
- The banker can exercised the right of set-off only in respect of- debts due and determined.
- The following condition are required to be fulfilled before a banker can exercise the right of set-off- (a)The debt must be a sum certain and due immediately, (b) The debt must be due by and to the same parties and the in the same right, (c) There should be no agreement to the contrary.
- The right to set-off account arise immediately in the following cases- (a) On the death, mental incapacity or insolvency of a customer, (b) On the insolvency of a firm, or on the liquidation of a company, (c) On the receipt of garnishee order.
- The right of set-off is available to the banker only in respect of- credit balance held in a customer's account.
- In case of time barred debt- the bank can exercise the right of set-off provided the debts are due in the same sight.

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- Money held in a fixed deposit account may be set-off against an overdraft allowed to the same customer- only after the fixed deposit has matured for payment.
- For exercising the right of set-off- no document is required to be obtained from the customer.

**Right of appropriation**

1. The act of setting aside money for a specific purpose. A company or a government appropriates funds in order to delegate cash for the necessities of its business operations. This may occur for any of the functions of a business, including setting aside funds for employee salaries, research and development, dividends and all other uses of cash. Federal funds must be appropriated each year for government programs.

In business use, may also be known as "capital allocation."

2. The claiming of land or intellectual property by a company or organization, or otherwise marking ownership of previously unclaimed or contested property.

**Banker's legal duty of disclosure and related matters**

***The banker's duty of confidentiality to the customer***

It is an implied term of the contract between customers and their banks and building societies that these firms will keep their customers' information confidential. This confidentiality is not just confined to account transactions – it extends to all the information that the bank has about the customer.

But from time to time, mistakes happen and – for whatever reason – banks end up releasing information that they should have kept secret. Sometimes, the resulting breach of confidentiality is little more than technical (in other words, nothing really flows from it), but occasionally it can have major consequences.

**The Tournier principles**

First of all, a banker's duty of confidentiality is not absolute. The 1924 case of Tournier v National Provincial and Union Bank of England sets out four areas where a bank can legally disclose information about its customer. These principles still hold good today and are:

- Where the bank is compelled by law to disclose the information
- if the bank has a public duty to disclose the information
- if the bank's own interests require disclosure; and

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- Where the customer has agreed to the information being disclosed.

If we decide that a bank disclosed information under one or more of these circumstances, then we are unlikely to interfere. But most of the complaints we receive involve situations where the bank should not have disclosed information – because none of the Tournier principles applied.

**Liability**

If a bank discloses information about a customer in any circumstances other than those described above, then it has acted wrongly and should, as a general rule, be held liable for the reasonably foreseeable consequences of its action. Some banks seem to think it should make a difference if they disclosed the information by accident – but it does not. If a bank's carelessness leads to a breach of confidentiality that does not diminish the fact that the bank acted in breach of a fundamental duty it owed to its customer.

It is relatively rare for us to come across a case where information was disclosed deliberately. Mostly, it happens by accident.

**Consequences of a breach of confidentiality**

Customers rightly expect high standards from their banks and building societies. So if they discover that their private information has been wrongly divulged to someone else, they can become very unhappy – even if the disclosure has resulted in little more than minor frustration or embarrassment.

But even a minor mistake by a bank can lead to significant problems – particularly if the customer is running a business. We have seen cases where simple clerical errors have led to serious business losses.

The important point here is for the bank to look at the consequences of its actions for the customer – and to distinguish clearly between "loss" and "distress and inconvenience". All too often we find that banks fail to do this properly. Even where they accept they have done something wrong, they often try to settle the matter by offering the customer some money without first assessing either:

Whether the customer has experienced a true (and reasonably foreseeable) financial loss; or

The real extent to which the customer has suffered distress, embarrassment, or inconvenience.

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**Loss**

Both banks and customers need to take a realistic look at any real losses resulting from the bank's breach of confidentiality. The bank should generally be liable for losses that it could reasonably have foreseen when it disclosed the information.

In our experience, banks regularly fail to pay proper attention to the true costs that customers can incur as a direct result of the breach of confidentiality. The key, therefore, is for both parties to analyse and understand the true effects of the bank's actions.

**Distress and inconvenience**

Occasionally, customers who have experienced minimal or no financial loss feel that their "good name" has been "irreparably damaged" by what has happened. They may go on to claim large sums of money as compensation, perhaps quoting high-profile court cases. However, we take a more balanced view.

In exceptional circumstances we might award compensation of some hundreds of pounds for significant breaches of confidentiality. But any compensation we award is generally far more modest. Minor mistakes will warrant little more than a nominal payment, if any.

When assessing compensation for distress and inconvenience we follow the approach outlined in our technical briefing note awards for non-financial loss.

**Customers account with banks**

**Opening**

**Savings Bank Account**

A Savings bank account is the most common operating account for individuals and others for non-commercial transactions. A Savings account helps people to put through day-to-day banking transactions besides earning some return on the savings made. Banks generally put some ceilings on the total number of withdrawals permitted during specific time periods. Banks also stipulate certain minimum balance to be maintained in savings accounts. Normally a higher minimum balance is stipulated in cheque operated accounts as compared to non-cheque operated accounts.

Banks as a rule do not give overdraft facility in a saving account, but allow occasional overdrawing to meet contingencies.

**Who can open a Savings Account?**

* By a person in his / her name;

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* By two or more persons in their joint names payable to:
- Both or all of them or the survivor or survivors of them; OR
- Either or any more of them or the survivor or the survivors of them; OR
- Former / latter or survivor of a particular person during his lifetime or survivors jointly or survivor.

* Certain non-profit welfare organizations are also permitted to open Savings bank accounts with banks.

**What a bank asks for while opening an account?**

Banks are required to know true identity of the person wanting to open an account. Banks also seek introduction of the person from an existing account holder. Banks require photograph of the person to be kept on record for future identification purpose. In terms of government notification w.e.f. 01.11.1998, banks have to obtain PAN numbers (issued by Income Tax Dept.) of the account holder at the time of opening of the account. In the absence of PAN number customer should give a declaration in the prescribed format (form no.60 or 61 as the case may be).

**What the Customer needs to know while opening a Savings Account?**

Ask the bank officials about :

- Minimum balance requirements.
- Penal provisions if the balance falls below the minimum stipulated amounts or return of Cheques issued or instruments sent on collection.
- Collection facilities etc. offered and charges applicable.
- Details of charges, if any for issue of cheque books and limits fixed on number of withdrawals, cash drawings, etc.

**Fixed or Time Deposits**

Time deposits are deposits accepted by banks for a specified period of time. In terms of RBI directives the minimum period for which term deposits can be accepted is 15 days. The banks generally do not accept deposits for periods longer than 10 years.

1. Banks pay interest on term deposits based on the period of deposits and normally pay higher interest for longer term deposits.
2. Banks have full discretion to fix their interest rates on deposits and these rates are varied from time to time depending on market conditions.

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3. Changes made in interest rates from time to time do not alter the interest paid on the existing deposits.
4. When banks quote a certain percentage of interest per annum for a given period it is understood that interest payments are made on a quarterly basis (see IBA Master Charts).
5. The depositor can collect interest on every quarter or its discounted value at monthly rests or avail quarterly compounding benefits and receive principal and interest on maturity.
6. RBI has now permitted banks to quote a higher rate of interest for individual deposits more than Rs.15 lacs.
7. Banks are allowed to levy a penalty for premature encashment of deposits at their discretion. Banks generally pay interest on such deposits as applicable for the period which deposit has been kept with the bank (less penalty if levied).
8. Bank allow loans against the fixed deposits on demand. Margin retained over the deposit outstanding and interest rate charged thereon are decided by the bank and may vary from bank to bank.

**Opening of a time deposit Account**

Normally the requirements as given under savings bank account apply to time deposits also. However, photographs are not insisted for deposits below Rs.10,000/-. Also the requirements regarding furnishing of PAN number applies only to time deposits over Rs.50,000/- made in cash.

Time deposits - Product variations

To suit the needs of the customers banks have introduced innovative variations in the basic time deposit format. Flexible deposit is one such innovation. In this case a given deposit is split into units of smaller amounts for accounting purposes. This enables the customer to encash any number of units prematurely at any time during the currency of the deposit and earn the contracted rate of interest on the balance amount.

**Current Account**

Current accounts are cheque operated accounts maintained for mainly business purposes. Unlike savings bank account no limits are fixed by banks on the number of transactions permitted in the Account. Banks generally insist on a higher minimum balance to be maintained in current account. Considering the large number of transactions in the account and volatile nature of

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balances maintained overnight banks generally levy certain service charges for operating a Current account.

In terms of RBI directive banks are not allowed to pay any interest on the balances maintained in Current accounts.

However, legal heirs of a deceased person are paid interest at the rates applicable to Savings bank deposit from the date of death of the account holder till the date of settlement.

Operation

**KYC and Operation**

- KYC (Know Your Customer) is a framework for banks which enables them to know / understand the customers and their financial dealings to be able to serve them better.
- Banking operations are susceptible to the risks of money laundering and terrorist financing.

Therefore, banks are advised to follow certain customer identification procedure for opening of accounts and monitoring transactions of a suspicious nature for the purpose of reporting it to appropriate authority.

- Reserve Bank of India has advised banks to make the Know Your Customer (KYC) procedures mandatory while opening and operating the accounts and has issued the KYC guidelines under Section 35 (A) of the Banking Regulation Act, 1949.
- Any contravention of the same will attract penalties under the relevant provisions of the Act. Thus, the Bank has to be fully compliant with the provisions of the KYC procedures.

**When does KYC apply?**

- ➢ Opening a new account.
- ➢ In respect of accounts where documents as per current KYC standards have not been submitted while opening the initial account.
- ➢ Opening a Locker Facility where these documents are not available with the Bank for all the Locker facility holders.
- ➢ When the Bank feels it necessary to obtain additional information from existing customers based on conduct of account.
- ➢ When there are changes to signatories, mandate holders, beneficial owners etc.

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- For non-account holders approaching the Bank for high value one-off transactions like Drafts, Remittances etc.

**Advantages of KYC**

- Sound KYC procedures have particular relevance to the safety and soundness of banks, in that:

1. They help to protect banks' reputation and the integrity of banking systems by reducing the likelihood of banks becoming a vehicle for or a victim of financial crime and suffering consequential reputational damage;
2. They provide an essential part of sound risk management system (basis for identifying, limiting and controlling risk exposures in assets & liabilities

**Objective of KYC guidelines**

- To prevent banks from being used, intentionally or unintentionally, by criminal elements for money laundering activities. KYC procedures also enable banks to know/understand their customers and their financial dealings better which in turn help them manage their risks prudently.

4 key elements of KYC policies

1) Customer Acceptance Policy;
2) Customer Identification Procedures;
3) Monitoring of Transactions; and
4) Risk management

**Types of Account**

One of the main functions of a commercial bank is to accept deposits of money from the public. The deposit accepted by a bank may be classifies into two broad categories

| **Time Deposits** | **Demand Deposits** |
|---|---|
| 1. Fixed Deposits | 1. Savings Deposits |
| 2. Recurring Deposits | 2. Current Deposits |

**Time Deposits**

The time deposits are repayable after expiry of a fixed specified period time while demand deposits are repayable on demand.

i) Fixed deposits

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Fixed deposits are those deposits, which are repayable after the expiry of a fixed specified period of time. They are also called time deposits. The time or period of deposit may vary from fifteen days to several years. This period decided by the depositor according to his convenience. The rate of interest is usually higher than other types of deposits. The rate of interest on fixed deposit depends on period of deposit; the longer the period of deposit, the higher will be the rate of interest. The RBI decides the interest rate. On the deposit being made, the banker issues a 'deposit receipts'

ii) Recurring deposit

Recurring deposits are variants of fixed deposits. Recurring deposits are also repayable only after the expiry of a fixed specified period of time but the amount is deposited in monthly installments. These deposits are meant for people having regular monthly income. The duration of recurring deposits varies from six months to several years. Generally the rate of interest on these deposits is higher.

**Demand Deposits**

i) Savings Deposits

Savings bank accounts are introduced by banks to mobilize small savings and inculcate the habit of savings in the people. These deposits are repayable on demand, but bank places certain restrictions on the number of withdrawals. These deposits can be opened with very small amount. The prescribed minimum balance is different in different banks. Interests is paid on monthly minimum balances and credited to the respective accounts half yearly according to the rates prescribed by the RBI from time to time.

ii) Current Accounts or Current Deposits

Current accounts are those deposits, which are repayable on demand. There are no restrictions on the number of withdrawals. The bank don't pay interest on current account or deposits, instead they change incidental charge on customers having current account. This type of deposit is suitable for businessmen who want to make payments by means of cheques.

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**Types of customers**

- **Lunatics**

A lunatic is person of unsound mind (irresponsible person). The position of lunatics under Indian law, Under Indian contract Act, a contract with or by a lunatic are void. The reason being the lunatic being of unsound mind is not competent to comprehend a contract.

If the banker without knowing that the person is lunatic opens an account and enters into a contract acting in good faith is protected. But when once he gets a notice of lunacy of a person, he should not entertain any contract either existing or new.

- **Drunkards**

Under section 12 of Indian contract Act 1872, a sane man who is delirious from favor or who is drunk that he can't under the contract, or form rational judgment can't enter into contract while delirium or drunkenness lasts. When a customer who is drunk presents a cheque across a counter the payment must be witnessed.

- **Minors**

Under section 3 of the Indian majority act, 1875, a minor is a person who has not completed the age of 18 years. In case a guardian to the person or property of minor is appointed by the court, or the property of the minor is placed under the charge of court wards before he completes the age of 18 years, he continues to be a minor until he completes the age of 21 years.

- **Married women**

The law that exists today in India doesn't make any distinction between the contractual capacity of a man or an unmarried lady and a married woman. So, a married woman enjoys the same contractual capacity as a man or an unmarried lady. She can acquire and sell property, lend or borrow and enter into contracts and bind her personal or separate property called "Stridhan".

- **Partnership firm**

Section 4 of partnership act 1932, defines partnership as "the relation between persons who have agreed to share the profits of a business carried on by all or any of them acting for all". So, a partnership is an association of two or more persons who agree to carry on a business jointly and share the profits of that business. The person who form the partnership are called "partners" individually and a "firm" collectively. The name under which they carry on the business is called "firm name". They can open the account in their firm's name.

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- **Joint stock companies (Public Limited Companies)**

A joint stock company is an association of persons under the companies act. It is an artificial person created by law with perpetual succession and common seal. A joint stock company is a separate legal entity. So, a bank account can be opened in its name.

However, while opening and maintaining an account in the name of public limited company, a banker has to be very careful. He is required to take the following precautions in dealing with a public limited company:

1. He should call for and examine the original certificate of incorporation to ascertain whether the company is legally incorporated or not. The certificate of incorporation is the conclusive proof of the incorporation of the company.
   It is also advisable for the banker to obtain and retain under his custody a certified copy of the incorporation certificate for his future reference.
2. He should obtain a certified copy of the memorandum of association of the company as amended up to date and ascertain the objects for which the company is formed, the authorized capital of the company and the liability of the members of the company. A knowledge of the objects of the company as specified in the Memorandum of association is absolutely necessary for the banker, because any act done, or contract entered by the company, which is outside the scope of the objects, is ultra-virus, (i.e. beyond the powers of company) and is, therefore not binding on the company.

- **Trustee**

Section 3 of Indian Trust contact Act, 1882 defines a trust as 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" so, a trustee is person to whom the management of a property is entrusted by one in trust, i.e. out of confidence reposed in him, for the benefit of another. In short, a trustee is one who manages a trust.

**Nomination**

Nomination is a facility that enables a deposit account holder(s) (individual or sole proprietor) or safe deposit locker holder(s) to nominate an individual, who can claim the proceeds of the

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deposit account(s) or contents of the safe deposit locker(s), post the demise of the original depositor(s) or locker holder(s).

***Benefit of nomination***

The benefit of nomination is that in the event of death of an account holder(s) or locker holder(s), the Bank can release the account proceeds or contents of the locker to the nominee(s) without insisting upon a Succession Certificate, Letter of Administration or Court Order. The nominee holds the monies in the capacity of a Trustee on behalf of the legal heirs of the deceased account holder(s) or locker holder(s) and the Bank's liability is duly discharged on payment to the Nominee.

***Who can nominate?***

- Bank account holders having deposit accounts in their individual names or in joint names of two or more individuals can appoint a nominee to their accounts.
- A sole proprietor can appoint a nominee to the sole proprietorship account with the bank.
- In the case of a deposit account in the name of a minor, nomination shall be made by a person lawfully entitled to act on behalf of the minor in respect of a deposit account.
- Safe deposit locker holder(s) can appoint nominee(s) on their Safe deposit locker(s).
- A nomination can be made only in respect of a deposit account which is held in the individual capacity of the depositor, and not in any representative capacity such as the holder of an office like Director of a Company, Secretary of an Association, partner of a firm, or Karta of an HUF.

***How can register a nomination?***

Specific nomination forms need to be completed and submitted to the Bank for registering the nomination facility. Different forms are applicable to register nominations on deposit accounts and safe deposit lockers. The Bank will acknowledge receipt of the nomination form and send a confirmation of having recorded the same. This confirmation must be kept securely either with the deposit account holder or with the nominee, if the account holder so wishes.

**Settlement of death claims**

An announcement of death in newspaper, production of a death certificate or a report from a reliable source etc., will be sufficient notice to the Bank about the death of the Account Holder.

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As soon as the Branch becomes aware of the death of the A/C Holder, it will record the fact in the relevant account in the system and stop operation in the A/C.

*Intimation to the Nominee, if any:*

If the deceased A/C holder had appointed a nominee, a letter will be issued to the nominee informing him/her about the death of the account holder.

*Further operation in the Account:*

Further operation in the different types of account will be allowed as follows:-

*a) Individual A/Cs:*

No further cheques should be paid even though they be dated prior to the date of death of the A/C holder.

*b) Joint A/Cs:*

If the balance is payable to the survivor(s), cheques signed by the survivor(s) may be paid to the debit of the a/c, but it is preferable that survivor(s) is/are advised to close the a/c and transfer the balance to a new a/c in his/her/their name(s)., Fresh Account Opening Form duly filled in and signed by the survivor(s) should be obtained. If the balance is not payable to the survivor(s), the a/c should be stopped.

*c) Proprietary A/Cs:*

No further cheques should be paid even though they be dated prior to the date of death of the A/C holder.

*d) Partnership A/Cs:*

The death of a partner has, ordinarily, the legal effect of dissolving the firm. The surviving partner(s) can, however, operate the A/C for the purpose of winding up; and any cheques drawn by the surviving partner(s) can be paid. Cheques drawn by the deceased partner and presented after his death, should not be paid. The branches should request the surviving partner(s) to close the a/c by drawing a cheque signed by all of them and open a new a/c through which all further transactions may be passed.

*e) Joint Hindu Family Firm A/c:-*

In case of death of the Karta, the operation in A/c should be stopped.

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*f) Trust A/cs.:-*

The Trustees have to act jointly unless there is an express provision to the contrary in the Trust Deed. In case of death of any, trustee, the operation on the a/c should be stopped unless the, relative Trust Deed confers express powers on the surviving trustee to act. In the absence of any specific provision in the Trust Deed, it is not safe for the Bank to assume that the surviving trustees possess full powers to deal with the A/C. Branches should, therefore, not allow the surviving trustees to operate on the a/c or withdraw the balance. In case of death of sole trustee, operation on the A/C should be immediately stopped.

*g) Executor's and Administrator's A/C: -*

On the death of an executor or administrator unless otherwise provided for the in the Will or Probate or Letter of Administration, all the powers of the office bearers become vested in the surviving executors or administrators. ,

The a/c should be allowed to be operated by co-executor(s), but the cheques signed by the deceased executor or administrator and presented after notice of his death should not be paid in the a/c. In case of death of a sole Executor or Administrator, it will be necessary to obtain fresh order of the court appointing a new Administrator.

*h) Limited Company's A/Cs:*

Where notice of death is received in respect of a person who is authorized to operate an A/C of a Limited Co., outstanding cheques drawn by such person of the Company can still be paid. The Board resolution submitted by the Company regarding the operation of its A/C should be examined by the branch to see whether any amendment or new resolution is necessary.

*i) Association, Society, club A/c.:*

The instructions given in respect of Limited Company's A/Cs shall also apply to A/Cs of Association, Society, Club etc.

*j) Accounts operated by a holder of Power of Attorney or Letter of Mandate:*

Upon the death of the principal, the authority of Attorney or Mandate holder stands cancelled. The operation on the a/c should be immediately stopped and no cheques signed by Attorney/Mandate holder should be paid after receipt of notice of death of the Principal.

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**Module 3**

## The Negotiable Instruments Act 1881

- In India law relating to negotiable instruments is contained in negotiable instruments Act 1881.
- "A negotiable instrument means a promissory note, bill of exchange or cheque payable either to order or to bearer".

**Features of Negotiable Instruments**

1. Negotiability- it means transferability. It can be transferred without any formality.

2. Property- The possessor of negotiable instrument is presumed to be the owner of the property contained therein.

3. Equivalent to cash- Even though is a document it is as good as cash.

4. Recovery- The transferee of the negotiable instrument can sue in his own name, in case of dishonor for the recovery of the amount without giving notice to the debtor.

5. Contract- A negotiable instrument is a contract to pay money.

6. Prompt payment-A negotiable instrument enables the holder of the instrument to expect prompt payment.

7. A negotiable instrument can be transferred any number of times till it is at maturity and the holder of the instrument need not give any notice of transfer to the debtor

**Important concept and explanations under the Negotiable Instruments Act**

**The Paying Banker**

The bank on which a cheque is drawn (the bank whose name is printed on the cheque) and which pays the amount for which the cheque is written and deducts that sum from the customer's account.

A Banker who holds the account of the drawer of the cheque and is obliged to make payment, if the funds of the customer are sufficient to cover the amount of he cheque drawn or if overdrawing facility is given to the customer**.**

**Protection Available to PayingBanker**

- Banker's Protection Negotiable Instruments Act 1881
- Certain Sections of the Act

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**Cheque**

- A cheque is a bill of exchange drawn on a specified banker and not expressed to be payable otherwise than on demand. That is the drawer directs the bank to pay a certain sum to payee on his demand.

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

Definition

"A bill of exchange drawn upon a specified banker and payable on demand"

Rules

1. All Cheques are bill of exchange but all bill of exchanges are not Cheques.
2. Usually banks provide their customers with printed cheque forms which are filled up and signed by the drawer.
3. The signatures must tally with specimen signature of the drawer kept in the bank.
4. A cheque must be dated.
5. A cheque becomes due for payment on the date specified in it.
6. A cheque drawn on a future date is valid but it is payable on and after the date specified. Such Cheques are called postdated Cheques.

*Essentials of a Cheque*

1. It must be unconditional order
2. It must be in writing
3. It must be drawn on a specified banker
4. it must be signed by the drawer
5. The order must be for the payment of a certain sum of money only
6. Drawer, drawee and payee must be certain
7. The payee must be certain
8. The amount must be payable on demand

**Dishonor of Cheques**

- A negotiable instrument may be dishonored by non-payment or non-acceptance.
- A cheque and promissory note may be dishonored by non-payment and

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- a bill of exchange may be dishonored either by;
    1. Non acceptance or by
    2. Nonpayment.

*1. Dishonor by Non Acceptance*

A bill of exchange is said to be dishonored by any one of the following **reasons;**

a) If the drawee does not accept the bill within 48 hrs from the time of presentment
b) If there are several drawees and all of them do not accept
c) When the presentment of acceptance is excused, and the bill is not accepted. (Say some excuse for acceptance)
d) When drawee become insolvent or died
e) When the drawee gives a limited acceptance
f) When the drawee is incompetent to contract
g) When the drawee is a fictitious person

*2. Dishonour by Non-Payment*

A promissory note, bill of exchange, or cheque is said to be dishonoured by nonpayment if the maker fails to make payment on the date of maturity.

A cheque is dishonored by non payment as soon as a banker refuses to pay.

***Notice of dishonour***

- When a negotiable instrument is dishonoured the holder must give notice of dishonour to all the prior parties

Notice by whom?

1. Notice by holder or any other a party
2. Chain method of notice of dishonour
3. Notice by principal or agent

Form of Notice

1. It may be oral or written
2. Clearly indicate the reason for dishonour
3. It must be given within in a reasonable time

***Circumstances when a banker is bound to dishonour of a cheque***

1. When the customer countermands payment

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2. Garnishee order (issued by high court)
3. Death, Insolvency or insanity of the customer
4. Notice of assignment (letter to transfer)
5. Defective title of the party
6. Loss of cheque
7. Postdated or stale cheque
8. When the cheque is irregular (may change cheque book, any information missing)
9. Closing of account
10. On transfer of accounts
11. When a cheque is Mutilated (Torn)
12. When there is material alteration
13. When the amount in words and figures differs
14. If the cheque is undated
15. he cheque is not presented in banking hours

**Negotiation**

It is the transfer of an instrument from one person to another in such a manner so as to convey the title and constitute the transferee the holder thereof. It may be;

a. Negotiable by mere delivery

Payable even to agent to keep it for payee

b. Negotiable by endorsement and delivery

Unless the holder signs his endorsement on the instrument, the transferee does not become a holder.

**Endorsement**

The literal meaning of the word endorsement is writing on the back of an instrument. Under the NI Act, it means, writing of the name of the endorsee on the back of the instrument by the endorser under his signature with the object of transferring the rights therein.

If an instrument is fully covered with endorsements and no space is left, further endorsement can be made on a slip of paper (called **alonge**) annexed thereto

**Kind of Endorsement**

*1. Blank or general endorsement*

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Just put the signature 0of endorser without mention the name of endorsee

Eg: sd/-

D.Mohan

*2. Special or full endorsement*

Including the name of endorsee

Eg:

Pay to Ghosh or order sd/-

D.Mohan

*3. Restrictive endorsement*

An endorsement, when it prohibits or restricts the further negotiation of the instrument.

Eg: pay to Ghosh only sd/-

D.Mohan

*4. Conditional or Qualified*

An endorsement is conditional or qualified if it limits or negates the liability of the endorser

Eg: pay to ghosh on Signing a receipt Sd/-

D.mohan

*5. Partial endorsement*

When an endorser endorses only a part of the amount mentioned in the instrument. it is irregular

**The collecting Banker**

A Collecting Banker is one who undertakes to collect various types of instruments representing money in favour of his customer or his own behalf from the drawers of these instruments; some are negotiable instruments as provided for in the negotiable instruments Act. 1881 and some are quasi negotiable instruments.

***Duties & Responsibilities of Collecting Bankers:***

*Acting as agent*: While collecting an instrument, whether for credit to customer's account or for himself, the Bankers works as agent of his customer. As an agent he has generally to take such steps & precautions to protect the interest or his customer as a man of ordinary prudence would take to safe-guard his own interest.

*Scrutinizing the instruments*: Name of the holder, Branch name, date, amount in world and figure, any cutting without signature, material alteration of any to be checked carefully.

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*Checking the endorsement*: Bankers has to check the instrument whether it has been endorsed properly.

*Presenting the instrument in due time*: It is the responsibility of the collecting bank to present the instrument in due time to the paying bank.

*Collecting the proceeds in the payee's account*: It is the duty of collecting banks to collect and credit the proceed of the instruments to the proper/correct account.

*Notice of dishonor and returning the instruments*: If any instrument is dishonored by the paying bank it should be informed to the customer on the business day following the receipt of the unpaid instruments.

***Collecting Banker's Protection:***

Under section 131 of negotiable instrument Act the collecting banker is not liable to the true owner of a cheque or a banker's draft if his title to the instrument proves defective provided the cheque or draft was one crossed generally or specially to himself and collected for a customer is good faith and without negligence.

The above statutory protection is available to the collecting banker only if he fulfills the following conditions:

- The cheque he collected is a crossed cheque.
- He collected such crossed cheque only for his customer as an agent & not as a holder for value.
- He collected such crossed cheque in good faith and without negligence.

**Negligence**

There are a variety of ways in which a bank can be considered to be negligent in undertaking its duties towards its customers, many of which are noted in the discussion above by implication. In broad terms, for the customer to raise the issue, it will be necessary to challenge the efficiency of the security mechanisms put in place by the bank or offer a credible alternative explanation for what happened.

**Bill of exchange**

A bill of exchange is an instrument in writing containing the 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".

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Three parties:

- The maker of bill of exchange is called the drawer.
- The person who is directed to pay is called the drawee.
- The person who will receive the money is called the payee

Specimen of bill of exchange

- Rs 5000 Place.

Date.

On demand pay to Rajesh or order, the sum of Rs 5000/- (Rupees Five thousand only) for value received.

To Ajith Sd- Stamp

(Address) Babu

- Here Babu is the drawer
- Ajith is the drawee (Acceptor)
- Rajesh is the payee

*Essentials of bill of exchange*

- The instrument must be in writing.
- The instrument must contain an order to pay.
- There must be three parties.
- The instrument must be signed by the drawer.
- The amount of money to be paid must be certain.
- The payee must be certain.
- It must comply with the formalities as regards date, stamp etc.

**Promissory note**

"A promissory note is an instrument in writing 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".

Two parties:

- The person who makes the promissory note and promises to pay is called the maker.
- The person to whom the payment is to be made is called the payee.
- Eg I promise to pay A or order Rs 500.

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*Essentials of a promissory note*

1. Pro notes must be in writing
2. A Promise to pay must be express.
3. Definite and unconditional
4. To be signed by the maker
5. Certainty in the case of parties.
6. Certainty in the case of sum of money
7. Promise to pay money only
8. Formalities are not essential. Formalities like time, place registration Number etc is not required. But it must be stamped as per stamp act.
9. It may be payable on demand or after a definite period of time - Where there is no time is mentioned the note is payable on demand.

**Discharge of negotiable instruments**

- An instrument is said to be discharged when all rights of action under it are completely extinguished and when it ceases to be negotiable.
- This would happen when the party who is ultimately liable on the instrument is discharged from liability.
- In such a case even in holder in due course does not acquire any right under the instrument

***Modes of Discharge***

1. by payment.
2. By Debtor as a holder
2. By express waiver- holder gives up his right.
3. By cancellation-holder may cancel the instrument.
4. by material alteration or lapse of time.

***Discharge of a party or parties***

1. By payment
2. By cancellation
3. By release (let loose)
4. By allowing drawee more than 48 hours

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5. By delay in presentment of cheque
6. Cheque payable to order (fraudlent payee)
7. By operation of law
8. By material alteration
9. By taking limited acceptance
10. By not giving notice of dishonour

**Hundis**

A **hundi** is a financial instrument that developed in Medieval India for use in trade and credit transactions. **Hundis** are used as a form of remittance instrument to transfer money from place to place, as a form of credit instrument or IOU to borrow money and as a bill of exchange in trade transactions.

**Types of Hundis**

- **Sahyog Hundi**: This is drawn by one merchant on another, asking the latter to pay the amount to a third merchant. In this case the merchant on whom the hundi is drawn is of some 'credit worthiness' in the market and is known in the bazaar. A sahyog hundi passes from one hand to another till it reaches the final recipient, who, after reasonable enquiries, presents it to the drawee for acceptance of the payment. Sahyog means co-operation in Hindi and Gujrati, the predominant languages of traders. The hundi is so named because it required the co-operation of multiple parties to ensure that the hundi has an acceptable risk and fairly good likelihood of being paid, in the absence of a formalized credit monitoring and reporting framework.
- **Darshani Hundi**: This is a hundi payable on sight. It must be presented for payment within a reasonable time after its receipt by the holder. Thus, it is similar to a demand bill.
- **Muddati Hundi**: A muddati or miadi hundi is payable after a specified period of time. This is similar to a time bill.

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**Module 4**

**Banking Technology**

**Concept of universal banking**

Universal banking is a combination of Commercial banking, Investment banking, Development banking, Insurance and many other financial activities. It is a place where all financial products are available under one roof. So, a universal bank is a bank which offers commercial bank functions plus other functions such as Merchant Banking, Mutual Funds, Factoring, Credit cards, Housing Finance, Auto loans, Retail loans, Insurance, etc.

**Advantages of Universal Banking**

The benefits or advantages of universal banking are:-

*Investors' Trust*: Universal banks hold stakes (equity shares) of many companies. These companies can easily get other investors to invest in their business. This is because other investors have full confidence and faith in the Universal banks. They know that the Universal banks will closely watch all the activities of the companies in which they hold a stake.

*Economics of Scale*: Universal banking results in economic efficiency. That is, it results in lower costs, higher output and better products and services. In India, RBI is in favour of universal banking because it results in economies of scale.

*Resource Utilization:* Universal banks use their client's resources as per the client's ability to take a risk. If the client has a high risk taking capacity then the universal bank will advise him to make risky investments and not safe investments. Similarly, clients with a low risk taking capacity are advised to make safe investments. Today, universal banks invest their client's money in different types of Mutual funds and also directly into the share market. They also do equity research. So, they can also manage their client's portfolios (different investments) profitably.

*Profitable Diversification*: Universal banks diversify their activities. So, they can use the same financial experts to provide different financial services. This saves cost for the universal bank. Even the day-to-day expenses will be saved because all financial services are provided under one roof, i.e. in the same office.

*Easy Marketing*: The universal banks can easily market (sell) all their financial products and services through their many branches. They can ask their existing clients to buy their other products and services. This requires less marketing efforts because of their well-established

brand name. For e.g. ICICI may ask their existing bank account holders in all their branches, to take house loans, insurance, to buy their Mutual funds, etc. This is done very easily because they use one brand name (ICICI) for all their financial products and services.

*One-stop Shopping*: Universal banking offers all financial products and services under one roof. One-stop shopping saves a lot of time and transaction costs. It also increases the speed or flow of work. So, one-stop shopping gives benefits to both banks and their clients.

***Disadvantages of Universal Banking***

The limitations or disadvantages of universal banking are:-

*Different Rules and Regulations*: Universal banking offers all financial products and services under one roof. However, all these products and services have to follow different rules and regulations. This creates many problems. For e.g. Mutual Funds, Insurance, Home Loans, etc. have to follow different sets of rules and regulations, but they are provided by the same bank.

*Effect of failure on Banking System*: Universal banking is done by very large banks. If these huge banks fail, then it will have a very big and bad effect on the banking system and the confidence of the public. For e.g. Recently, Lehman Brothers a very large universal bank failed. It had very bad effects in the USA, Europe and even in India.

*Monopoly:* Universal banks are very large. So, they can easily get monopoly power in the market. This will have many harmful effects on the other banks and the public. This is also harmful to economic development of the country.

*Conflict of Interest*: Combining commercial and investment banking can result in conflict of interest. That is, Commercial banking versus Investment banking. Some banks may give more importance to one type of banking and give less importance to the other type of banking. However, this does not make commercial sense.

**Home banking**

The practice of conducting banking transactions from home rather than at branch locations. Home banking generally refers to either banking over the telephone or on the internet. The first experiments with internet banking started in the early 1980s, but it did not become popular until the mid-1990s when home internet access was widespread. Today, a variety of internet banks exist which maintain few, if any, physical branches.

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**ATMs (Automated Teller Machines)**

ATMs are primarily used for performing some of the banking functions such as the withdrawal of cash or the deposit of cash/cheque, etc., by using an ATM card.

***Convenience of ATMs***

- To the customer

- 24/7 access availability
- Less time for transactions (less queue)
- Privacy in transactions
- Any branch/anywhere banking enabled
- Acceptability of card across multiple bank ATMs, even foreign tourists can access Maestro/visa ATMs
- Other services enabled in ATMs in addition to cash dispending includes clearing cheques deposits balance enquiry, cheque book requisition, details of recent transactions.

- To the Bank

- Cost of setting up ATMs is lower than setting up a branch
- Migration of the routine transactions to the ATMs frees the bank staff for more productive work
- ATMs serve as the crucial touch point for cross-selling of the bank's products
- Enable the banks to display products on the screen and serves as a media for publicity for the bank
- Less hassle in handling cash.

***ATMs customer Inference***

The following components of the ATM provide the customer interface:

- Video Display Monitor
- Keyboard/Keypad
- Touch screen

***Future perspective of ATMs***

The future plans include expanding the network by connecting more ATMs over the next five years for:

- Increasing the number of transactions per day per ATM

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- Establishing connectivity with point of sale (POS) terminals at merchant establishments
- e-ticketing in railways, roadways and airway
- Providing international payment networks such as VISA and master card.

**Internet Banking**

- A system allowing individuals to perform banking activities at home, via the internet.
- The automated delivery of new and traditional banking products and services directly to customers through electronic, interactive communication channels.
- Some online banks are traditional banks which also offer online banking, while others are online only and have no physical presence.

**Who can use internet banking?**

Step 1: Access Internet Banking - Obtain your User ID and Passwords.

Step 2: Create your Own Unique User ID.

Step 3: Link the Account Number to your User ID

**Advantages**

- ❖ Cost less
- ❖ Transaction speed
- ❖ Efficiency
- ❖ Speed banking
- ❖ Vast coverage

**Issues in internet banking**

- ❖ Security
- ❖ Learning difficulties
- ❖ Lack of skilled personnel
- ❖ Technical breakdowns
- ❖ Long start up time
- ❖ inexpensive

**Security risks**

- ✓ Increasing number of fraudulent websites
- ✓ Fake emails purporting to be sent from banks
- ✓ Use of Trojan horse programs to capture user ids and password

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**Mobile Banking**

Use mobile device to connect to a financial institution to view account balances and transactions, transfer funds between accounts, pay bills, receive account alerts, deposit checks, etc.

***Mobile Payment***

- Use mobile device for purchase or other payment-related transaction at point of sale (proximity) or via internet (remote)
- May be conducted via SMS, MMS, mobile Internet, downloadable application, contactless or barcode technology
- Process and settle over traditional banking networks (credit, debit, ACH), mobile carrier or other third party network

***Forms of Mobile Banking***

- ➢ **SMS (Short Message Service)**: Send & receive text messages & alerts
- 90% of US phones
- Limited to 160 characters
- Uses existing carrier infrastructure
- Less security, no encryption
- **WAP (Wireless Application Protocol):** Browser access via mobile phone to Internet content
- 60% of US phones
- No downloads required
- For online banking customers
- Small screen, slower data Transmission, expensive data plan
- ➢ **Downloadable Smartphone Application**: User friendly apps customized to smart phone type
- ➢ 30% of US phones
- ➢ Blackberry, iPhone, Android
- ➢ Faster navigation, easy setup , more secure
- ➢ Involves custom application development

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**Mobile Remote Deposit**

- Use phone's camera to capture front & back images of check & send to bank for deposit
- Expected high adoption rate with consumers and small businesses that process low check volumes
- Reduces Bank's paper check process costs
- Less reliance on branch
- USAA first to offer m-RDS
  - (Deposit @ Mobile for iPhone & Android)
- Chase Quick Deposit – July 2010
- BoA to launch with iPhone in 2011

***Mobile Banking Security***

***Preventive Measures***

*Banks*

- Secure (encrypt) communication channels: SMS, browser based, downloadable apps
- Assign security levels & user authentication based on payment type, transaction value, number of daily transactions, etc.
- Set transaction limits
- Know your vendor: ensure mobile apps have built-in safeguards to limit security breaches in case device lost or stolen
- Apply due diligence for new customers by authenticating account number and user name
- Educate consumers on security policies and tools

*Consumers*

- Set strong passwords, install anti-virus software on smart phones
- Know the developer before downloading applications
  - How well have they tested the app?
  - Is it certified?
- Do not store sensitive data on mobile phone
- Receive mobile alerts on potentially fraudulent transactions

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**Core Banking Solutions**

- Sum total of all the information technology components that enable a bank to manage its core business activities in a centralized model
- Round the clock processing of all the products, services and information of a bank
- 24/7/365 Model

***Application Areas***

- Balance of payments and withdrawal are done.
- Mobile banking
- Internet banking
- ATM's
- Recording of transactions
- Passbook maintenance
- Interest calculations on loans and deposits
- Customer records

***Technical Terms***

- Data Centre (DC) – The place where the central server / servers are housed.
- Disaster Recovery Site (DRS) – An alternate data centre which will act as a backup resource and ensure business continuity in case of a DC failure.
- Data Mirroring – Storage devices attached to Servers located in DC and DRS are updated on a real time basis, so that data integrity as well as availability are ensured even in case of a hardware failure. Bank's real time data is stored in multiple devices and locations.
- Backup – Data stored in the fixed storage devices are copied on to removable storage devices / tapes and preserved for any future contingency. These backups are stored in some off-site location to avoid the damages on account of a disaster like earth quake, fire, flood etc.
- Leased Lines – These are the primary data links used for CBS networking. These are analog links on fixed yearly rentals and there are no additional usage charges.
- ISDN Lines – These are the secondary data links put to use in case of a Leased line failure. These are integrated services digital network lines which can carry various forms of information packets (data, voice and images and video) as digital signals.

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- Modem – This is networking equipment used to modulate and demodulate the data signals. Computers work on digital data signals whereas the leased lines can carry only the analog signals. Modems modulate (convert the digital signals to analog signals) at the transmitting end and then demodulate (Convert the analog signals to digital signals) at the receiving end.
- Switch – In a branch there can be more than one computer and these computers are networked to form a local area network (LAN) using a device called switch.
- Router – Router is another network device that connects different LANs and facilitates intelligent data transfer. Router also functions as an intelligent switching device between various connectivity channels, viz., leased line, ISDN, PSTN etc. When the primary link (LL) is down, it automatically dials the ISDN and re-establishes the network connectivity**.**
- Regional Cluster Centre (RCC) - Instead of taking separate links between individual branches and the data centre, branches in a geographical region are first connected to a location in that region and this location is then connected to the data centre using links of higher band width. This location is termed as a *regional cluster centr*e. Some banks also house their regional data servers in RCC, so that in case of a total network failure between RCC and DC, branches in that region can continue to operate and also provide Any Branch Banking (ABB) facilities within the cluster

***Need Of Core banking solution***

- To meet the intense competition and changing market dynamics in an over banked environment.
- To meet the regulations and compliance requirements (example in order to meet the Basel II norms banks must enhance their IT infrastructure).
- To meet the demands of customers who are better informed, more demanding and less loyal than ever.
- To enhance efficiency and effectiveness.
- Increasing customer satisfaction and convenience
- Freeing up time for branch staff to focus on sales and marketing
- Simplifying process for employees

- Enhancing bank's competitiveness in the market
- Improved process efficiency Shrinking margins.

**Benefits to Banks**

- Replace old technology seamlessly with a state-of-the-art n-tier application.
- Replace multiple disparate and older generation systems with a single integrated multi-product processing application across various countries.
- Streamline operations by integrating the enterprise, to existing in house applications and to offer a single customer view.
- Create a virtual banking operation from ground-up and offer a host of banking products.
- Enable multiple new delivery channels (Internet Banking, 7 X 24 ATM, Mobile Banking, Tele-banking and Point of Sale Terminals) allowing the bank to reach out to new customers and segments.
- Move to centralized processing and handle much higher volumes without a proportionate increase in resources or infrastructure costs.
- Use business intelligence tools to analyze customer needs and create new products and offerings.
- Build and retain customer relationships based on the strength of customer service capability.
- Enable and modify product offerings quickly and efficiently based on customer's market needs.
- Reduce costs, improve bottom-line and stakeholder rewards.
- Quick and easy introduction of new products and services

**Benefits to Customer**

- Customer can enjoy the Online and real time banking facilities through ATMs
- Point of sale terminals (POS) Internet
- Mobile phones and Kiosks
- Quick realization of instruments lodged for collection
- on-line and easy fund transfer (intra-bank as well as inter-bank) etc

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**Debit card**

A bank-issued card that allows its user to access their funds for the purpose of paying for merchandise. A debit card acts like a credit card, the difference being that funds are immediately taken from the cardholders accounts.

**Credit card**

Pre-approved credit which can be used for the purchase of items now and payment of them later.

***Classification of Credit card***

***Based on mode of credit recovery***

- Charge Card-A card that charges no interest but requires the user to pay his/her balance in full upon receipt of the statement, usually on a monthly basis. While it is similar to a credit card, the major benefit offered by a charge card is that it has much higher, often unlimited, spending limits.
- Revolving credit card-A line of credit where the customer pays a commitment fee and is then allowed to use the funds when they are needed. It is usually used for operating purposes, fluctuating each month depending on the customer's current cash flow needs

***Based on status of credit card***

- Standard Card- it is a generally issued credit card
- Business Card- (Executive cards) it is issued to small partnership firms, solicitors, tax-consultants, for use by executives on their business trips.
- Gold Card-a credit card issued by credit-card companies to favoured clients, entitling them to high unsecured overdrafts, some insurance cover, etc

***Based on geographical validity***

- Domestic card- Cards that are valid only in India and Nepal are called domestic cards.
- International Card- credit Cards that are valid internationally are called international cards.

***Based on franchise/ Tie-up***

- Proprietary card- A bank issues such cards under its own brands. E.g. SBI card Cancard of Canara bank
- Master Card- this card is issued under the umbrella of “MasterCard International”
- VISA Card – it is issued by any bank having tie up with “VISA international”

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- Domestic Tie-up Card- it is issued by any bank having tie up with domestic credit card brands such as CanCard and IndCard.

***Based on issuer Category***

- Individual Cards- Non-corporate cards that are issued to individuals
- Corporate Cards- Issued to corporate and business firms.

**Smart card**

The smart card looks exactly like any other plastic card or an ATM card with an integrated circuit (IC Chip) installed. The IC chip contains memory, may contain a processor, and communicates with the external world through contacts on the surface of the card. The size, position and utility of the contacts are specified by an international standard, so that cards can interact with a variety of equipment.

**Electronic Payment systems**

Electronic Payment is a financial exchange that takes place online between buyers and sellers. The content of this exchange is usually some form of digital financial instrument (such as encrypted credit card numbers, electronic Cheques or digital cash) that is backed by a bank or an intermediary, or by a legal tender.

Electronic payment system is a system which helps the customer or user to make online payment for their shopping.

The various factors that have lead the financial institutions to make use of electronic payments are:

Decreasing technology cost:

The technology used in the networks is decreasing day by day.

Reduced operational and processing cost:

Due to reduced technology cost the processing cost of various commerce activities becomes very less. A very simple reason to prove this is the fact that in electronic transactions we save both paper and time.

Increasing online commerce:

***Some Examples of EPS***

- Online Reservation
- Online Bill Payment

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- Online Order Placing (Nirulas)
- Online Ticket Booking ( Movie)

***Two Storage Methods***

- On-line
  - Individual does not have possession personally of electronic cash
  - Trusted third party, e.g. online bank, holds customers' cash accounts
- Off-line
  - Customer holds cash on smart card or software wallet
  - Fraud and double spending require tamper-proof encryption

***Types of EPS***

1. E-cash: A system that allows a person to pay for goods or services by transmitting a number from one computer to another. Like the serial numbers on real currency notes, the E-cash numbers are unique. This is issued by a bank and represents a specified sum of real money.
2. E-wallets: The E-wallet is another payment scheme that operates like a carrier of e-cash and other information. The aim is to give shoppers a single, simple, and secure way of carrying currency electronically. Trust is the basis of the e-wallet as a form of electronic payment.
3. smart cards
4. credit cards

***Microsoft cheque truncation***

- Movement of the physical instrument is curtailed
- Image of the payment instrument is captured along with MICR data simultaneously
- Clearing Process completed based on Electronic data and image of the Cheques

***Benefits of the cheque truncation system***

- Facilitate Banks to increase productivity and avail all the benefits of smarter technology of Electronic Cheque Presentment
- Better Operational efficiency
- Faster clearing cycle of payment instruments
- Cost saving in terms of storage and transport cost

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- Optimal Customer satisfaction

***Business Opportunities - Banks***

- Improved handling of post-dated Cheques deposited by the customer, as the images can be scanned and stored and the system can automatically process the scanned images on the due date.
- Improved business intelligence systems can be put in place.
- Introduction of new payment system products like e-Cheques
- Better funds management
- Reduction in Transaction cost
- Better management of space and manpower
- Improved regulatory compliance.
- Improved Management Information Systems which will facilitate better decision making.

***Business Opportunities - Customer***

- Faster realization of Funds
- Better funds management
- Can avoid visit to the Branch as more outlets will be available for depositing Cheques for clearing, at convenient locations.

***Business Opportunities -Vendors***

- Upgrade of Technology opens up new business opportunities for vendors and solution providers.
- Can improve the Brand image of their products by providing improved functionalities for image capture, storage and retrieval
- Scope for improvement in processing capabilities , especially scanners and servers

***Point of Truncation***

- Originating Branch
- ATM / Customer Location
- An identified Branch for a Cluster of Branches
- Service Bureau
- Service Branch of Originating Bank

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***Factors to decide point of Truncation***

- Infrastructure required
- Capital Cost for set up
- Recurring Costs
- Distance of the Originating branches from the point of truncation
- Technology used
- Volume of Cheques / images that will be processed
- Facilities available for storing the Cheques & images and their retrieval
- PC with printer
- Scanner
- Network
- The configuration of scanner will depend on the volume of Cheques ( Documents per minute) - Approximate capacity – 30 documents per minute (DPM)
- Capacity of scanner - Documents per minute
- Storage of Images – ( Size of 3 prescribed images along with Digital Signature – 75 KB )
- Front Gray Scale, Front Black & White and Reverse Black and White

**ECS (Electronic Clearing Service)**

- Electronic mode of payment / receipt for 1 transactions that are repetitive and periodic in nature.
- ECS is used by institutions for making bulk 2 payment of amounts towards distribution of dividend, interest, salary, pension, etc
- For bulk collection of amounts towards telephone 3 / electricity / water dues, cess / tax collections, loan installment repayments, periodic investments in mutual funds, insurance premium etc

***Parties involved in ECS payment system***

- Payee- one who is going to receive
- Payer- one who is going to pay
- Payee's bank
- Payer's bank
- Clearing House- Facilitates the interaction between two banks

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***Prerequisites to avail the ECS facility***

- Both the parties must have bank accounts
- Banks involved have to be the member of the local clearing house

***Types of ECS process***

- Credit request
    - Example of a credit request:
        - Jivan Tyres Ltd. has to pay monthly salaries to its employees who have accounts across different banks
        - The initiator can be the paying bank, requesting a credit to the receiving bank
- Debit Request
    - Example of a Debit request
        - State Electricity board wants to receive monthly bill payment monthly from its customers
        - In this case the initiator of the process is the payee's bank

***Payment process in case of a cheque***

- Initiator is always the presenting bank (bank that demands for payment and further receives payment) requesting the debit to the paying bank

**EFT (Electronic Fund Transfer)**

- Exchange of money from one account to another through computer
- Cardholder-initiated transactions, using a payment card such as a credit ordebit card
- Direct deposit payment initiated by the payer
- Direct debit payments, sometimes called *electronic checks*, for which a business debits the consumer's bank accounts for payment for goods or services
- Wire transfer via an international banking network such as SWIFT
- Electronic bill payment in online banking, which may be delivered by EFT or paper check
- Transactions involving stored value of electronic money, possibly in a private currency

***Process of EFT***

- Entering Supplier Master Information
- Entering Payment Instrument Defaults

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- Entering Bank Account Information

**Various modes of EFT in India**

- NEFT-NATIONAL ELECTRONIC FUNDS TRANSFER
- RTGS-REAL TIME GROSS SETTLEMENT
- IMPS-IMMEDIATE PAYMENT SERVICE

NEFT-National Electronic Funds Transfer

- The National Electronic Funds Transfer is a nation-wide money transfer system which allows customers with the facility to electronically transfer funds from their respective bank accounts to any other account of the same bank or of any other bank network
- Funds transfer through NEFT requires a transferring bank and a destination bank.
- Before transferring funds via NEFT you register the beneficiary, receiving funds. For this you must possess information such as name of the recipient, recipient's bank name, a valid account number belonging to the recipient and his respective bank's IFSC code.
- Any sum of money can be transferred using the NEFT system with a maximum capital of Rs. 10, 00, 000.

RTGS- Real time Gross Settlement

- It is a real time funds transfer system which facilitates you to transfer funds from one bank to another in real time or on a gross basis. The transaction isn't put on a waiting list and cleared out instantly.
- RTGS payment gateway, maintained by the Reserve Bank of India makes transactions between banks electronically. The transferred amount is instantly deducted from the account of one banks and credited to the other bank's account.
- The minimum value that can be transferred using RTGS is Rs. 2 Lakhs and above. However there is no upper cap on the amount that can be transacted.
- The remitting customer needs to add the beneficiary and his bank account details prior to transacting funds via RTGS. The details required while transferring funds would be the beneficiary's name; his/her account number, receiver's bank address and the IFSC code of the respective bank.

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IMPS- Immediate Payment Service

- The National Payments Corporation of India introduced a pilot mobile payment project also known as the Immediate Payment Service (IMPS).
- IMPS offers instant electronic transfer service using mobile phones. The IMPS service also features a secure transfer gateway and an immediate confirmation on fulfilled orders.
- IMPS is offered on all the cellular devices via Mobile Banking or through SMS facility.
- To be able to transfer money via IMPS route you must first register for the immediate payment services with your bank
- Thus IMPS enables customers to use mobile instruments as an instant money transfer gateway, facilitating user convenience and saving time and effort involved in other modes of transfer.

Advantages of EFT

- Increase efficiency and productivity.
- Manage cash flow easily.
- Improve safety and control.
- Saves money.
- Less paper works.
- Eliminate the risks associated with lost, stolen, or misdirected cheques
- EFT Provides our office with the capacity to,

✓ Automate our payments.
✓ Electronically update our accounts information.
✓ Streamline our cash flow.
✓ Reduce administrative cost.
✓ Eliminate overdue accounts.
✓ Manage delayed disbursements.
✓ Get set up and add customers.

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**Module 5**

**International Banking**

**Exchange rates and forex business**

- ***Fixed Exchange Rate System***

Fixed rates provide greater certainty for exporters and importers.

- ***Flexible Exchange Rate System***

Flexible exchange rate or floating exchange rates change freely and are determined by trading in the forex market.

***Exchange rate fluctuations***

A reliable forecast or future spot rate is called study of empirical patterns of exchange rate fluctuation. It provides essential information for an exchange rate exposure.

| Market | Information | Forecasting |
|---|---|---|
| Weak | No information | Required |
| Semi strong | Published information | Not required |
| Strong | Published plus private information | Not required |

***Foreign exchange*** is the mechanism by which the currency of one country gets converted into the currency of another country.

The conversion of currency is done by the banks who deal in foreign exchange. These banks maintain stocks of one currencies in the form of balances with banks

**Operation of foreign exchange market:**

***Foreign exchange market operates either as:-***

***Spot Market: (Current Market)***

Spot market for foreign exchange is that market which handles only spot transaction or current transactions.

***Principle characteristics:-***

- Spot Market is of daily nature. It does not trade in future deliveries.

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- Spot rate of exchange is that rate which happens to prevail at the time when transactions are incurred.

***Forward Market:***

Forward Market for foreign exchange is that market which handles such transaction of foreign exchange as are meant for future delivery.

***Principles Characteristics:-***

- It only caters to forward transaction.
- It determines forward exchange rate at which forward transaction are to be honored.

***The Foreign Exchange Market for Beginners***

- The foreign exchange market or forex market as it is often called is the market in which currencies are traded.
- Currency Trading is the world's largest market consisting of almost trillion in daily volumes and as investors learn more and become more interested, market continues to rapidly grow.
- All trades that take place in the foreign exchange market involve the buying of one currency and the selling of another currency simultaneously. This is because the value of one currency is determined by its comparison to another currency.
- The first currency of a currency pair is called the "base currency," while the second currency is called the counter currency.
- Foreign exchange Capital Markets (FXCM) is an online currency trading firm that offers a free demo account to traders who are new and interested in the foreign exchange market.
- Registering for a demo account allows a new trader to download the online trading platform that is used by the company's clients trading live accounts and make trades as if they were doing it with real money.

***Characteristics of foreign exchange***

- Its huge trading volume representing the largest asset class in the world leading to high liquidity.
- Its geographical dispersion;

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- Its continuous operation: 24 hours a day except weekends, i.e., trading from 20:15 GMT on Sunday until 22:00 GMT Friday.
- The use of leverage to enhance profit and loss margins and with respect to account size.

**Correspondent banking and NRI accounts**

- A Correspondent Banking relationship involves the provision of banking services by one financial institution (a Correspondence bank) to another financial institution (Correspondent Banking Client)
- In which the financial institution carry on activities or business at or through permanent establishments in different countries
- It is also possible for one bank to open a *Correspondence Account* with another bank that already has an existing Correspondent facility
- The banking services provided by Correspondent Bank may involve *provision of cash management services, international fund transfers, check clearing, foreign exchange services, loans and letters of credit*
- Correspondent banking as the banking services – mainly payments, cash management and trade services - provided by banks to customers via other banks.

**NRI Accounts**

***Types of NRI bank account***

- Non-Resident Externals (NRE) Fixed Deposits
- Non-Resident Ordinary (NRO) Savings Account
- Foreign Currency Non-Resident (FCNR)Fixed Deposits
- Resident Foreign Currency (RFC)Fixed Deposits

***Non-Resident External (NRE) Fixed Deposits***

The Non Resident External (NRE) saving account is open for Indian residing abroad .this account will help you to transfer foreign earning easily to India .NRE account can be opened in any bank as saving and fixed deposit account.

***Benefits of NRE Account***

- There is no tax and no wealth tax
- The currency maintain in this account is in Indian rupees

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- Funds can be easily transferred from NRE account to NRO account
- Joint account facility is available with only NRI`s.
- Nomination facility is available with only NRI Indians

***Non-Resident Ordinary (NRO) Savings Account***

Non Resident ordinary (NRO) account is just like any other bank account with the only difference that this account is being opened for only those individuals who are leaving India for taking an employment or establishing a business outside India. The existing accounts for these Indians are also termed as Ordinary Non Resident account or an NRO Accounts. These accounts can also be opened through foreign remittance. Thus it's a rupee denominated account

***Benefits of NRO Account***

- Interest earned on these accounts is high as Banks can themselves determine interest rates.
- These accounts also offer joint account facility with a resident or a NRI individual.
- Nomination facility is available with both NRI and resident Individuals.

***Foreign currency nonresident (FCNR) fixed deposit***

FCNR Deposits are maintained in foreign currency and they are completely safe against any exchange rate fluctuations.

***Benefits of FCNR***

- Interest is payable in the same currency of the deposit at Half yearly.
- FCNR account can be opened jointly with other non-residents.
- FCNR a/c can be converted or amount transferred to NRE accounts.
- No income tax on interest earned.

***Resident Foreign Currency (RFC) Fixed Deposits***

RFC Deposit has been specially created for persons of Indian nationality or origin returning to India permanently for settlement after having been a resident outside India for a continuous period of at least one year.

***Benefits of RFC***

- The account will be denominated in USD, GBP, and EURO.
- The account can be held singly or jointly.
- The account can be maintained in the form of Term Deposit account.

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- The balance in the account can be freely used for local disbursements.

***Additional Service [Money Transfer]***

- An individual resident Indian can borrow sum not exceeding USD 250,000 or its equivalent staying outside India, subject to the conditions that:
- The minimum maturity period of the loan is one year;
- The loan is free of interest;

**Letters of Credit**

A **letter of credit** is a document from a bank guaranteeing that a seller will receive payment in full as long as certain delivery conditions have been met. In the event that the buyer is unable to make payment on the purchase, the bank will cover the outstanding amount.

***Types of Letter of Credit***

Most letters of credit are **import/export letters of credit** which, as the name implies, are used in international trade. The same letter of credit would be termed an import letter of credit by the importer and an export letter of credit by the exporter. In most cases the importer is the buyer and the exporter is the beneficiary.

The **revocable letter of credit** can be changed at any time by either the buyer or the issuing bank with no notification to the beneficiary. The most recent version of the UCP, UCP 600, did away with this form of letter of credit for any transaction under their jurisdiction. Conversely, the **irrevocable letter of credit** only allows change or cancellation of the letter of credit by the issuing bank *after* application by the buyer and approval by the beneficiary. All letters of credit governed by the current UCP are irrevocable letters of credit.

A **confirmed letter of credit** is one where a second bank agrees to pay the letter of credit at the request of the issuing bank. While not usually required by law, an issuing bank might be required by court order to only issue confirmed letters of credit if they are in receivership. As you might guess, an **unconfirmed letter of credit** is guaranteed only by the issuing bank. This is the most common form with regard to confirmation.

A letter of credit may also be a **transferrable letter of credit**. These are commonly used when the beneficiary is simply an intermediary for the *real* supplier(s) of the goods and services or is one of a group of suppliers. It allows the named beneficiary to present its own documentation but

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transfer all or part of the payment to the actual supplier(s). As you might guess, an **un-transferrable letter of credit** does not allow transfer of payments to third parties.

A letter of credit may also be **at sight**, which is payable as soon as documentation has been presented and verified, or payment may be **deferred** (also called a **usance letter of credit**) until a certain time period has passed or the buyer has had the opportunity to inspect or even sell the related goods.

A **red clause** letter of credit allows the beneficiary to receive partial payment before shipping the products or performing the services. Originally these terms were written in red ink, hence the name. In practical use, issuing banks will rarely offer these terms unless the beneficiary is *very* creditworthy or an advising bank agrees to refund the money if the shipment is not made.

Finally, a **back to back letter of credit** is used in a trade involving an intermediary, such as a trading house. It is actually made up of two letters of credit, one issued by the buyer's bank to the intermediary and the other issued by the intermediary's bank to the seller.

**Foreign currency Loans**

Foreign currency loans are all loans given or taken for which the contract currency is different to the local currency (balance sheet/company code currency).

***Eligibility***

- Exporters for working capital needs
- Importers for meeting import obligations
- Importers of capital goods
- Those customers who have earlier raised medium-term FC Loans for meeting capital expenditure from overseas financial institutions, so that these loans can be foreclosed (subject to RBI guidelines)
- Loan to JV/WOS entities of Indian companies.
- High value corporate clients with a good track record, to meet working capital requirements in substitution of WCDL
- Those customers who are looking for conversion of rupee term/cash credit.

***Period***

- Working capital for exporter/importer- 6 months to one year.
- Importers of capital goods-3 years (subject to availability of funds)

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- Substitution of WCDL/Cash Credit – 6 months to one year.
- In case of Term Loan Conversion- 6 months to 3 years (subject to availability of funds)

***Quantum/ Currency***

- On transaction to transaction basis within the existing credit facilities
- Minimum USD 0.50 mn. (Rs. 2.00 Crores) equivalent.
- Normally in US$, FC Loans can also be availed in Pound Sterling or in Euros subject to availability of funds

***Rate of Interest***

Bench marked to relevant LIBOR rates.

***Repayment***

- Bullet payment (one lump sum) by:
- Tendering export documents
- Proceeds of export collection bills
- Debit to EEFC accounts
- Purchase of foreign currency from the bank at contracted/ready rate if forward booking is waived.
- Term loans for import of capital goods – repayment in stipulated installments
- Conversion of rupee term loans – as per original sanction terms

***Procedure***

- Roll-over at the sole discretion of the Bank
- In case of loans on floating rate basis the rates will be reset once in every six months
- Interest charged on reducing balance method.
- Forward cover for appropriate maturity to be booked.
- Forward cover can be waived for customers having natural hedge.
- Prepayment generally not permitted
- In exceptional cases prepayment permitted. However, as an exception, prepayment is permitted in certain cases, with levy of penalty.

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**Facilities for exporters and importers**

***Facilities for Exporter***

***Export Credit***

***Rupee export credit (pre-shipment and post-shipment) :***

- Bank offers both pre and post shipment credit to the Indian exporters through Rupee denominated loans as well as foreign currency loans in India.
- Exporters having firm export orders or L/C from a recognized Bank can avail the export credit facilities from United Bank of India provided they satisfy the required credit norms. The details of the credit norms can be obtained from the nearest authorized branch of the Bank.
- Post shipment rupee export credit is available for a maximum period of -180- days /360daysfrom the date of first disbursement. The corporate, if required can book forward contracts in respect of future export credit drawals.

***Export bill rediscounting:***

- Bank offers financing of export by way of bill discounting of export bills to provide post shipment finance to the exporters at competitive international rate of interest.
- The export bills (both Sight and Usance) can be purchased/ discounted provided they comply with the norms of the Bank/ RBI.
- All exporters are eligible to cover the bills drawn under L/C, non-credit bills under sanctioned limits under the Bill discounting Scheme.

***Export credit in foreign currency***

***Pre-shipment credit in foreign currency (PCFC):***

- Bank provides PCFC in the foreign currency to the exporters enabling them to fund their procurement, manufacturing/ processing and packing requirements. These loans are available at very competitive international interest rates covering the cost of both domestic as well as import content of the exports. The PCFC can be availed in US$, Euro, GBP and Japanese Yen.
- The corporate / exporters with a good track record can avail a running account facility with the Bank for PCFC. To qualify for this purpose, the exporter's overdue bill should not exceed 5% of the average annual export realization during the preceding -3- years.

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- PCFC in foreign currency is available for a maximum period of -180- days from the date of first disbursement similar to the case of Rupee facility.

***Export bill rediscounting:***

- Bank offers financing of export by way of bill discounting of export bills to provide post shipment finance to the exporters at competitive international rate of interest. This facility is available in -4- currencies i.e. US$, Pound Sterling, Euro and JPY.
- The export bills (both Sight and Usance) can be purchased/ discounted provided they comply with the norms of the Bank/ RBI.
- All exporters are eligible to cover the bills drawn under L/C, non-credit bills under sanctioned limits under the Bill discounting Scheme.

***Exporter Gold Card***

Bank has formulated Gold Card Scheme for its exporter clients based on the scheme drawn up by Reserve Bank of India. The scheme proposes to ensure easy availability of export credit on best terms to credit worthy exporters with good track record. The card to be offered by United Bank of India will be known as 'United Bank of India Expo Gold Card'. The salient features of the scheme are as under:

***Eligibility under the Scheme:***

All exporters , including those in small and medium sector having good track record and credit worthiness depending on the credit rating done as per bank's norms.

Exporters whose accounts have been classified as 'Standard' continuously for a period of three years and there are no irregularities/adverse features in the conduct of the accounts will be considered.

The scheme will not be applicable to those exporters who are blacklisted by ECGC or included in RBI's defaulter's list/caution list or making losses for the past 3 years or having overdue export bills in excess of 10 per cent of the current year's turnover.

In order to recognize exporters undertaking exports on collection basis, it has been decided that they will also be considered for grant of United Bank of India Expo Gold Card under the above scheme provided they have been dealing with our bank for a period of at least three years.

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***Fixation of Credit Limit:***

In-principle limits will be sanctioned for a period of three years with a provision for automatic renewal under this scheme subject to fulfillment of the terms and conditions of sanction.

Efforts will be made to meet PCFC requirements of the Gold Card holders by giving them priority over non-export borrowers. Bank will also consider providing foreign currency term loans to Gold Card Holders on priority basis.

**Non Fund Based Facilities & Other Services**

***Non-Fund Based Facilities***

United bank of India issues Bid Bond, Performance and other guarantees in favour of the beneficiaries abroad on behalf of Indian Exporter customers.

***Other Services***

- Advising / Confirmation of Export Letters of Credit: Exporters can insist their export letter of credit are advised through United Bank of India to ensure timely delivery.
- Assisting in compiling credit reports on the overseas buyers.
- Derivative products to cover exchange risk
- Collection of exports bills: Concentrating your Documentary collection activities with United Bank of India your exporting hassles is eliminated. You will experience fewer delay in receiving export proceeds and have efficient cash management.
- Maintains EEFC Account of its customers. The Exchange Earners Foreign Currency (EEFC) Deposits Scheme was started by RBI in the year 1992 with the introduction of Liberalized Exchange Rate Management System. Under this scheme, the recipient of inward remittances, exporters and other eligible bodies are allowed to keep a portion of their inward remittances / export proceeds in foreign currency with the banks in India which can later be utilized for permissible purposes

**Bank Facilities for Importers**

***Import Finance:***

Bank provides various types of funding/ services to the importers for facilitating the imports in the country. The vast network of branches and Correspondent Banks worldwide facilitate prompt & efficient services to the importers. All the facilities are subject to the prevalent rules of the Bank/ RBI guidelines.

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***The various facilities provided are*:**

- Collection of import bill.
- Opening of Import L/Cs (Sight/ DA)
- Financing of import by way of Foreign Currency Loans
- Issuing Guarantees etc. on behalf of importers.

***Collection of import bills:***

The import bills are collected through the 47 authorized branches at very competitive rates. The Bank has correspondent relationship with reputed International Banks throughout the world and can provide the services to importers who may be importing from any part of the globe.

***Letter of credit:***

- Bank offers L/C facility for the purchase of goods in the international market. Being a Prime Bank of repute, the L/Cs of the United Bank of India are well accepted in the International market.
- With the Letter of Credit of United Bank of India, importers can build up better trust/ confidence in their suppliers and develop other business relationship at a much faster pace.
- The L/C facility can be granted to the importers after assessing their requirement/ credit worthiness/ financial strength and other parameters being to the satisfaction of the Bank.

***Bank guarantees:***

Bank on behalf of importers/ other customers issues guarantees in favour of beneficiaries abroad. The guarantees can be both Performance and Financial.

***Other services:***

- Bank Provides its customer facilities for hedging exchange risk by booking forward contracts,
- The Bank obtains credit report of the overseas seller for its customers and also undertakes remittance connected with the import including advance remittance.
- The Bank facilitates in arrangement of Buyers credit for importer customers and also issued LOC/LOU on behalf of their customers.

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**Role of ECGC, RBI and EXIM bank**

**Export Credit Guarantee Corporation of India (ECGC)**

- The ECGC Limited (ECGC) was established on 30 July 1957 with an objective to provide insurance cover in respect of risks in export trade.
- These risk may include loss of money on account of foreign buyer becoming bankrupt or sudden import or exchange restrictions resulting in stopping of payments etc.
- The Export Credit Guarantee Corporation of India Limited is a company wholly owned by the Government of India based in Mumbai, Maharashtra.
- It provides export credit insurance support to Indian exporters and is controlled by the Ministry of Commerce. Government of India had initially set up Export Risks Insurance Corporation (ERIC) in July 1957.
- It was transformed into Export Credit and Guarantee Corporation Limited (ECGC) in 1964 and to Export Credit Guarantee Corporation of India in 1983. In 2014 August, the Company was again renamed as ECGC Limited

**What does ECGC do?**

- Provides a range of credit risk insurance covers to exporters against loss in export of goods and services.
- Offers Export Credit Insurance for Bankers and financial institutions to enable exporters to obtain better facilities from them.
- Provides Overseas Investment Insurance to Indian companies investing in joint ventures abroad in the form of equity or loan.

**How does ECGC help exporters?**

- Offers insurance protection to exporters against payment risks
- Provides guidance in export-related activities
- Makes available information on different countries with its own credit ratings
- Makes it easy to obtain export finance from banks/financial institutions
- Assists exporters in recovering bad debts
- Provides information on credit-worthiness of overseas buyers

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**RBI:**

- RBI has issued Authorized Dealers (AD) licenses to banks, all India financial institutions and a few co-operative banks to undertake foreign exchange transactions in India
- It has also issued Money Changer licenses to a large number of established firms, companies, hotels, shops, etc.
- Money changers help facilitate encashment of foreign currencies of foreign tourists
- Entities authorized to buy and sell foreign currency notes, coins and travelers' Cheques are called full-fledged money changers
- Those authorized only to buy are called restricted money changers

**EXIM Bank**

Export-Import Bank of India (Exim Bank) was set up by an Act of the Parliament "THE EXPORT-IMPORT BANK OF INDIA ACT, 1981" for providing financial assistance to exporters and importers, and for functioning as the principal financial institution for co-ordinating the working of institutions engaged in financing export and import of goods and services with a view to promoting the country's international trade and for matters connected therewith or incidental thereto.

Exim Bank has two broad business streams: one, the traditional export finance typical of export credit agencies around the world and two, financing of export oriented units (export capability creation), which are non-traditional for export credit agencies. Since inception, Exim Bank has been the principal financial institution in the country for financing project exports and exports on deferred credit terms. As per Memorandum PEM (Memorandum of Instructions on Project Exports and Service Exports) of Reserve Bank of India, the following constitute project exports:

i. Supply of goods / equipment on deferred payment terms
ii. Civil construction contracts
iii. Industrial turnkey projects
iv. Consultancy / services contracts

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The covers issued by ECGC can be divided broadly into four groups:

1. *Standard Policy*

Shipments (Comprehensive Risks) Policy, which is commonly known as the Standard Policy, is the one ideally suited to cover risks in respect of goods exported on short term credit; i.e. credit not exceeding 180 days. The policy covers both commercial and political risks from the date of shipment.

2. *Other Specific Policies*

Specific Policies are designed to protect Indian firms against payment risks involved in a) exports on deferred terms of payment b) services rendered to foreign parties and c) construction works and turnkey Projects undertaken abroad. These policies are issued separately for each specific contract, and cover risks normally from the date of contract.

ECGC provides for an insurance cover named as Construction Works Policy to provide cover to an Indian contractor who executes a civil construction job abroad.

3. *Financial Guarantees*

Financial Guarantees are issued to banks in India to protect them from risks of loss involved in their extending financial support at pre-shipment and post-shipment stages. These also cover a host of non-fund based facilities that are extended to exporters.

Export Performance Guarantee

Export Performance Guarantee is an insurance cover for banks, which issues various kinds of guarantees on behalf of exporters in order to facilitate export transactions

4. *Special Schemes*

Transfer Guarantee meant to protect banks which add confirmation to Letters of Credit opened by foreign banks, Insurance cover for Buyers Credit and Lines of Credit, and Exchange Fluctuation Risk Insurance.

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# Module-6

## Banker as lender

### Types of loans

***Home Loan***

Home Loans are taken by people for a variety of home-related purposes such as construction of home, home renovation, home extension, buying of property or land, or payment of stamp duties. Home loans comprise an adjustable or fixed interest rate and payment terms. Some types of home loans are mentioned below:

- Home Purchase Loan
- Land Purchase Loan
- Home Construction Loan
- Home Extension Loan
- Home Renovation Loan
- Stamp Duty Loan
- NRI Home Loans
- Loan Against Property

***Personal Loan***

This type of loan is given to individuals after accessing their credentials based on their profession or business, or any other sources of income. The loan can be utilised for any purpose, for example, paying debt, marriage expenses or vacation expenditure. No collateral security is required for this type of loan. The span of personal loan repayment varies from 12 months to 60 months depending upon the principal amount and the EMIs. The interest rate ranges from 15 percent to 28 percent varying from bank to bank. Approximately 2 percent of the total loan amount is charged as the loan processing fee. Generally, banks rules prohibit prepayment of loan for the initial six months; otherwise 2 percent to 4 percent of the outstanding amount is charged as the prepayment fees. The EMI starts once the disbursement of loan has been made.

***Business Loan***

This type of loan is provided to either existing businesses or those venturing into new business. As banks provide loans on the basis of individual's credentials, it is bit difficult to get a loan for starting a business. It is very important for individuals (starting a business) to have a clear cut

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business plan as it is the most important requirement to convince the banks that your business has the capability of repayment. Banks then rely on individual's background, assets/property, previous loan history and dedication towards work. Banks also prefer those individuals who have already insured the property for their business. Nowadays, banks are working on providing more lucrative and easy business loans options for the first time business owners.

For existing businesses, loan is provided in the following ways:

*Term loans* – Amount provided for a fixed tenure at the applicable interest rate: three years for short term loan and 10-15 years for long term loans.

*Bank overdraft limits* – Ability to withdraw more money than what is deposited.

*Bill Discounting* – Short-term borrowing used to improve a company's working capital and cash flow position.

*Letter of credit for international business* – Bank guaranteeing of a buyer's payment to a seller in specified period.

***Education Loan***

Required by and provided to students who want to pursue higher education in resident country or abroad. Students should have an admission offer from an institution before they apply for an education loan. The loan takes care of the fees of the institution including examination and library fees; travel expenses for abroad; cost of books and equipments required; any insurance for the student, if applicable; and any additional expenses such as tours, thesis, project work, etc. The terms of education loans vary from bank to bank.

The RBI has fixed certain norms on the total amount of loan that can be disbursed; however, banks can increase or decrease the limit depending on the institution. For studying in India, Rs. 10 lakh is the average and for studying abroad, the average is Rs. 20 lakh. For a loan amount up to Rs. 4 lakh, parents should be the joint borrowers and above that amount, a guarantee or some security in terms of tangible assets is required, depending upon the bank. Simple rate of interest is charged depending upon the base rate of the bank.

It is not mandatory to pay the interest during the study period; however, if paid regularly during the study period, some concession is also provided by a few banks. The repayment tenure varies between 10 years and 15 years depending upon the loan amount and repayment begins between six months and two years of the course completion. Early repayment has no associated charges.

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***Gold Loan***

Gold loan is imparted only on providing gold as security to a bank or any other lending institution. It is considered as one of the safest methods as the loan amount is provided on the basis of the security submitted. Amount ranging from Rs. 5k to 25 lakh can be taken as loan against gold. Amount equivalent to 80 percent to 90 percent (varying from bank to bank) of the total value of the gold is given as loan to the borrower. Depending upon the bank, the tenure of gold loan varies from one day to two years. The extension of tenure is also allowed by few banks. The rate of interest usually ranges from 14 percent to 24 percent, depending upon the financial institution. The banks charge processing fees of up to 1.5 percent. There is no prepayment fee. You can repay the gold loan any time during the tenure. EMI policy also varies from bank to bank; few banks prefer EMIs where interest and principal are charged monthly, whereas few only charge the interest on a monthly basis and offer flexibility for the payment of the interest amount.

***Vehicle/ Car Loan***

Compared to other loans, it is easier and simpler to take vehicle loans. Vehicle loans involve less paperwork and around three to six working days are required to get the clearance. The interest rates vary from bank to bank based on their base rate. The repayment process involves monthly EMIs and early repayment options

**Overdraft facilities**

An overdraft occurs when money is withdrawn from a bank account and the available balance goes below zero. In this situation the account is said to be "overdrawn". If there is a prior agreement with the account provider for an overdraft, and the amount overdrawn is within the authorized overdraft limit, then interest is normally charged at the agreed rate. If the negative balance exceeds the agreed terms, then additional fees may be charged and higher interest rates may apply.

***Reasons for overdrafts***

Overdrafts occur for a variety of reasons. These may include:

*Intentional short-term loan* - The account holders finds themselves short of money and knowingly makes an insufficient-funds debit. They accept the associated fees and cover the overdraft with their next deposit.

*Failure to maintain an accurate account register* - The account holder doesn't accurately account for activity on their account and overspends through negligence.

*ATM overdraft* - Banks or ATMs may allow cash withdrawals despite insufficient availability of funds. The account holder may or may not be aware of this fact at the time of the withdrawal. If the ATM is unable to communicate with the cardholder's bank, it may automatically authorize a withdrawal based on limits preset by the authorizing network.

*Temporary Deposit Hold* - A deposit made to the account can be placed on hold by the bank. This may be due to Regulation CC (which governs the placement of holds on deposited checks) or due to individual bank policies. The funds may not be immediately available and lead to overdraft fees.

*Unexpected electronic withdrawals* - At some point in the past the account holder may have authorized electronic withdrawals by a business. This could occur in good faith of both parties if the electronic withdrawal in question is made legally possible by terms of the contract, such as the initiation of a recurring service following a free trial period. The debit could also have been made as a result of a wage garnishment, an offset claim for a taxing agency or a credit account or overdraft with another account with the same bank, or a direct-deposit chargeback in order to recover an overpayment.

*Merchant error* - A merchant may improperly debit a customer's account due to human error. For example, a customer may authorize a $5.00 purchase which may post to the account for $500.00. The customer has the option to recover these funds through chargeback to the merchant.

*Chargeback to merchant* - A merchant account could receive a chargeback because of making an improper credit or debit card charge to a customer or a customer making an unauthorized credit or debit card charge to someone else's account in order to "pay" for goods or services from the merchant. It is possible for the chargeback and associated fee to cause an overdraft or leave insufficient funds to cover a subsequent withdrawal or debit from the merchant's account that received the chargeback.

*Authorization holds* - When a customer makes a purchase using their debit card without using their PIN, the transaction is treated as a credit transaction. The funds are placed on hold in the customer's account reducing the customer's available balance. However the merchant doesn't

receive the funds until they process the transaction batch for the period during which the customer's purchase was made. Banks do not hold these funds indefinitely, and so the bank may release the hold before the merchant collects the funds thus making these funds available again. If the customer spends these funds, then barring an interim deposit the account will overdraw when the merchant collects for the original purchase.

*Bank fees* - The bank charges a fee unexpected to the account holder, creating a negative balance or leaving insufficient funds for a subsequent debit from the same account.[3]

*Playing the float* - The account holder makes a debit while insufficient funds are present in the account believing they will be able to deposit sufficient funds before the debit clears. While many cases of playing the float are done with honest intentions, the time involved in checks clearing and the difference in the processing of debits and credits are exploited by those committing check kiting.

*Returned check deposit* - The account holder deposits a check or money order and the deposited item is returned due to non-sufficient funds, a closed account, or being discovered to be counterfeit, stolen, altered, or forged. As a result of the check chargeback and associated fee, an overdraft results or a subsequent debit which was reliant on such funds causes one. This could be due to a deposited item that is known to be bad, or the customer could be a victim of a bad check or a counterfeit check scam. If the resulting overdraft is too large or cannot be covered in a short period of time, the bank could sue or even press criminal charges.

*Intentional Fraud* - An ATM deposit with misrepresented funds is made or a check or money order known to be bad is deposited (see above) by the account holder, and enough money is debited before the fraud is discovered to result in an overdraft once the chargeback is made. The fraud could be perpetrated against one's own account, another person's account, or an account set up in another person's name by an identity thief.

*Bank Error* - A check debit may post for an improper amount due to human or computer error, so an amount much larger than the maker intended may be removed from the account. Some bank errors can work to the account holder's detriment, but others could work to their benefit.

*Victimization* - The account may have been a target of identity theft. This could occur as the result of demand-draft, ATM-card, or debit-card fraud, skimming, check forgery, an "account takeover," or phishing. The criminal act could cause an overdraft or cause a subsequent debit to

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cause one. The money or checks from an ATM deposit could also have been stolen or the envelope lost or stolen, in which case the victim is often denied a remedy.

*Intraday overdraft* - A debit occurs in the customer's account resulting in an overdraft which is then covered by a credit that posts to the account during the same business day. Whether this actually results in overdraft fees depends on the deposit-account holder agreement of the particular bank.

**Discounting of bills**

Bill of Exchange, is an instrument in writing which is an unconditional order to pay a certain amount of money to a specified person.

The transaction is practically an advance against the security of the bill and the discount represents the interest on the advance from the date of purchase of the bill until it is due for payment. Under certain circumstances, the Bank may discount a bill of exchange instead of negotiating them.

- The seller who is the holder of a accepted B/E has two options :
    1. Hold on the B/E till maturity and then take the payment from buyer.
    2. Discount the B/E with discounting agency.

***Discount:***

- Seller can take the accepted B/E to a discounting agency and obtain ready cash.
- The act of giving accepted B/E for ready money is call discounting the B/E.
- The difference between ready money paid and the face value of the bill is called the discount.

***Types of Bills***

1. Demand Bill: This is payable immediately "at sight" or "on presentment" to the drawee. A bill on which no time of payment or "due date" is specified is also termed as a demand Bill.
2. Usance Bill: This is also called time bill. The term usance refers to the time period recognized by custom or usage for payment of bills
3. Documentary Bill: These are the B/Es that are accompanied by documents that confirm that a trade has taken place between the buyer and the seller of goods. These documents

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include the invoices and other documents of title such as railway receipts, lorry receipts and bills of lading issued by custom officials.

4. Clean Bill: These bills are not accompanied by any documents that show that a trade has taken place between the buyer and the seller. Because of this, the interest rate charged on such bills is higher than the rate charged on documentary bills.

***Creation of a B/E***

Suppose a seller sells goods or merchandise to a buyer. In most cases, the seller would like to be paid immediately but the buyer would like to pay only after some time, that is, the buyer would wish to purchase on credit. To solve this problem, the seller draws a B/E of a given maturity on the buyer. The seller has now assumed the role of a creditor; and is called the drawer of the bill. The buyer, who is the debtor, is called the drawee. The seller then sends the bill to the buyer who acknowledges his responsibility for the payment of the amount on the terms mentioned on the bill by writing his acceptance on the bill. The acceptor could be the buyer himself or any third party willing to take on the credit risk of the buyer.

**Financing book dates and supply bills**

When a bank receives a deposit of checks from a payee, it will credit the payee's account with the funds represented by the checks. However, the bank has not really received the cash yet, since it must still collect the funds from the bank of the paying party. Until the bank collects the funds, it is at risk of having a negative cash flow situation if the payee uses the cash it has just received.

To avoid this risk, the bank posts the amount of the deposit with a value date that is one or more days later than the book date. This value date is the presumed date of receipt of the cash by the bank. Once the value date is reached, the payee has use of the funds. The value date may be categorized by the bank as 1-day float, 2+-day float, or some similar term.

**Charging of security bills**

- Charging of security is done by banks to safe guard their advances by taking different kinds of securities reason being to fall back on it in case of loan is defaulted.

***Type of Charges***

- Assignment – it is a mode of providing security to a banker for an advance includes transfer of a right, property or debt.

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- Lien – right of the banker to retain possessions of the goods and securities owned by the debtor until debt due is paid
- Set-off – Total or partial merging of a claim of one person against another in a counterclaim by the latter against the former.
- Mortgage – Transfer of interest in immovable property to secure an advanced loan or an existing debt or performance of an obligation.
- Pledge – Bailment of goods for providing security for payment of debt or performance of promise.
- Hypothecation – Charge upon any movable property created by a borrower in favor of a secured creditor without delivery of possession of the movable property, also called as a mortgage of a movable property.

**Pledge**

- Bailment of goods as security for payment of debt or performance of a promise :PLEDGE
- Bailer: PAWNER
- Bailee: PAWNEE
- Example:
- A borrows Rs.100 from B & keeps his watch as security : pledge

***Rights of Pawnee***

- Right of retainer{S.173}: right to retain goods until dues paid
- Right of transfer for subsequent advances:{S.174}: on lending money to same debtor without further security ;right to retain earlier goods extends
- Right to extraordinary expenses {S.175}
- Right to sue the pawnor or sell the goods on default.

***Rights of Pawnor***

- Enforcement of pawnee's duties
- Defaulting pawnor's right to redeem

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**Mortgage**

A mortgage loan, also referred to as a mortgage, is used by purchasers of real property to raise capital to buy real estate; or by existing property owners to raise funds for any purpose while putting a lien on the property being mortgaged. The loan is "secured" on the borrower's property. This means that a legal mechanism is put in place which allows the lender to take possession and sell the secured property ("foreclosure" or "repossession") to pay off the loan in the event that the borrower defaults on the loan or otherwise fails to abide by its terms. The word mortgage is derived from a "law French" term used by English lawyers in the Middle Ages meaning "death pledge", and refers to the pledge ending (dying) when either the obligation is fulfilled or the property is taken through foreclosure. Mortgage can also be described as "a borrower giving consideration in the form of a collateral for a benefit (loan).

***Standard or conforming mortgages***

Many countries have a notion of standard or conforming mortgages that define a perceived acceptable level of risk, which may be formal or informal, and may be reinforced by laws, government intervention, or market practice. For example, a standard mortgage may be considered to be one with no more than 70-80% LTV and no more than one-third of gross income going to mortgage debt.

A standard or conforming mortgage is a key concept as it often defines whether or not the mortgage can be easily sold or securitized, or, if non-standard, may affect the price at which it may be sold. In the United States, a conforming mortgage is one which meets the established rules and procedures of the two major government-sponsored entities in the housing finance market (including some legal requirements). In contrast, lenders who decide to make nonconforming loans are exercising a higher risk tolerance and do so knowing that they face more challenge in reselling the loan. Many countries have similar concepts or agencies that define what are "standard" mortgages. Regulated lenders (such as banks) may be subject to limits or higher risk weightings for non-standard mortgages. For example, banks and mortgage brokerages in Canada face restrictions on lending more than 80% of the property value; beyond this level, mortgage insurance is generally required

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***Foreign currency mortgage***

In some countries with currencies that tend to depreciate, foreign currency mortgages are common, enabling lenders to lend in a stable foreign currency, whilst the borrower takes on the currency risk that the currency will depreciate and they will therefore need to convert higher amounts of the domestic currency to repay the loan

**Assignment**

- Essentially, an assignment is the transfer of ownership. An example of an assignment is when a person sells his or her car, thereby transferring the title to another.
- When assigned, the option writer has an obligation to complete the requirements of the option contract. If the option was a call (put) option, then the writer would have to sell (buy) the underlying security at the stated strike price.

**Example:**

One example of assignment is 'transfer by the holder of a life insurance policy (the assignor) of the benefits or proceeds of the policy to a lender (the assignee), as a collateral for a loan'. In such case in the event of the death of the assignor, the assignee is paid first and the balance (if any) is paid to the policy's beneficiary. However, insurance policies other than life insurance, may not be used for this purpose.

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**Module 7**

**Asset Liability Management (ALM) in Banks**

- The process by which an institution manages its balance sheet in order to allow for alternative interest rate and liquidity scenarios
- Banks and other financial institutions provide services which expose them to various kinds of risks like credit risk, interest risk, and liquidity risk
- Asset-liability management models enable institutions to measure and monitor risk, and provide suitable strategies for their management.

**Components of Liabilities**

1. Capital:

   Capital represents owner's contribution/stake in the bank.

- It serves as a cushion for depositors and creditors.
- It is considered to be a long term sources for the bank.

2. Reserves & Surplus

Components under this head includes:

I. Statutory Reserves
II. Capital Reserves
III. Investment Fluctuation Reserve
IV. Revenue and Other Reserves
V. Balance in Profit and Loss Account

3. **Deposits**

This is the main source of bank's funds. The deposits are classified as deposits payable on 'demand' and 'time'. They are reflected in balance sheet as under:

a) Demand Deposits
b) Savings Bank Deposits
c) Term Deposits

4. Borrowings: (Borrowings include Refinance / Borrowings from RBI, Inter-bank & other institutions)

I. Borrowings in India

i) Reserve Bank of India

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ii) Other Banks

iii) Other Institutions & Agencies

II. Borrowings outside India

5. Other Liabilities & Provisions

It is grouped as under:

I. Bills Payable

II. Inter Office Adjustments (Net)

III. Interest Accrued

IV. Unsecured Redeemable Bonds
(Subordinated Debt for Tier-II Capital)

V. Others (including provisions)

**Components of Asset**

***1) Cash & Bank Balances with RBI***

I. Cash in hand
(Including foreign currency notes)

II. Balances with Reserve Bank of India

In Current Accounts

In Other Accounts

Balances with Banks and Money at Call & Short Notice

I. In India

i) Balances with Banks

a) In Current Accounts

b) In Other Deposit Accounts

ii) Money at Call and Short Notice

a) With Banks

b) With Other Institutions

II. outside India

a) In Current Accounts

b) In Other Deposit Accounts

c) Money at Call & Short Notice

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**2) Investments**

A major asset item in the bank's balance sheet. Reflected under 6 buckets as under:

I. Investments in India in:

i) Government Securities

ii) Other approved Securities

iii) Shares

iv) Debentures and Bonds

v) Subsidiaries and Sponsored Institutions

vi) Others (UTI Shares, Commercial Papers, COD & Mutual Fund Units etc.)

II. Investments outside India in

Subsidiaries and/or Associates abroad

**3) Advances**

The most important assets for a bank.

A. i) Bills Purchased and Discounted

ii) Cash Credits, Overdrafts & Loans repayable on demand

iii) Term Loans

B. Particulars of Advances:

i) Secured by tangible assets (including advances against Book Debts)

ii) Covered by Bank/ Government Guarantees

iii) Unsecured

**4) Fixed Asset**

I. Premises

II. Other Fixed Assets (Including furniture and fixtures)

**5) Other Assets**

I. Interest accrued

II. Tax paid in advance/tax deducted at source (Net of Provisions)

III. Stationery and Stamps

IV. Non-banking assets acquired in satisfaction of claims

V. Deferred Tax Asset (Net)

VI. Others

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**Significance of Asset Liability Management**

- *Liquidity risk*: the current and prospective risk arising when the bank is unable to meet its obligations as they come due without adversely affecting the bank's financial conditions. From an ALM perspective, the focus is on the funding liquidity risk of the bank, meaning its ability to meet its current and future cash-flow obligations and collateral needs, both expected and unexpected. This mission thus includes the bank liquidity's benchmark price in the market.
- *Interest rate risk*: The risk of losses resulting from movements in interest rates and their impact on future cash-flows. Generally because a bank may have a disproportionate amount of fixed or variable rates instruments on either side of the balance-sheet. One of the primary causes are mismatches in terms of bank deposits and loans.
- *Currency risk management*: The risk of losses resulting from movements in exchanges rates. To the extent that cash-flow assets and liabilities are denominated in different currencies.
- *Funding and capital management*: As all the mechanism to ensure the maintenance of adequate capital on a continuous basis. It is a dynamic and ongoing process considering both short- and longer-term capital needs and is coordinated with a bank's overall strategy and planning cycles (usually a prospective time-horizon of 2 years).
- Profit planning and growth.
- In addition, ALM deals with aspects related to credit risk as this function is also to manage the impact of the entire credit portfolio (including cash, investments, and loans) on the balance sheet. The credit risk, specifically in the loan portfolio, is handled by a separate risk management function and represents one of the main data contributors to the ALM team.

**Purpose and objectives**

- An effective Asset Liability Management Technique aims to manage the volume, mix, maturity, rate sensitivity, quality and liquidity of assets and liabilities as a whole so as to attain a predetermined acceptable risk/reward ratio
- It is aimed to stabilize short-term profits, long-term earnings and long-term substance of the bank. The parameters for stabilizing ALM system are:

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- Net Interest Income (NII)
- Net Interest Margin (NIM)
- Economic Equity Ratio

**Prerequisites for ALM**

1. Awareness for ALM in the Bank staff at all levels–supportive Management & dedicated Teams.
2. Method of reporting data from Branches/ other Departments. (Strong MIS).
3. Computerization-Full computerization, networking.
4. Insight into the banking operations, economic forecasting, computerization, investment, credit.
5. Linking up ALM to future Risk Management Strategies.

**Assets and Liabilities Committee (ALCO)**

- ALCO, consisting of the bank's senior management (including CEO) should be responsible for ensuring adherence to the limits set by the Board
- Is responsible for balance sheet planning from risk - return perspective including the strategic management of interest rate and liquidity risks
- The role of ALCO includes product pricing for both deposits and advances, desired maturity profile of the incremental assets and liabilities,
- It will have to develop a view on future direction of interest rate movements and decide on a funding mix between fixed Vs. floating rate funds, wholesale vs. retail deposits, money market Vs. capital market funding, domestic vs. foreign currency funding
- It should review the results of and progress in implementation of the decisions made in the previous meetings

**Activities of ALCO**

- ALCO decision making unit- Responsible for balance sheet planning from risk return perspective
- Monitoring the market risk levels by ensuring adherence to the various risk limits set by the bank

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- Articulating the current interest rate view and a view on future direction of interest rate movements
- Deciding the business strategy of the bank, consistent with the interest rate view, budget and pre-determined risk management objectives
- Determining the desired maturity profile and mix of assets and liabilities
- Product pricing for both assets and liabilities side
- Deciding the funding strategy i.e. source and mix of liabilities or sale of assets
- Reviewing implementation of decisions made in the previous meeting

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