

Banking

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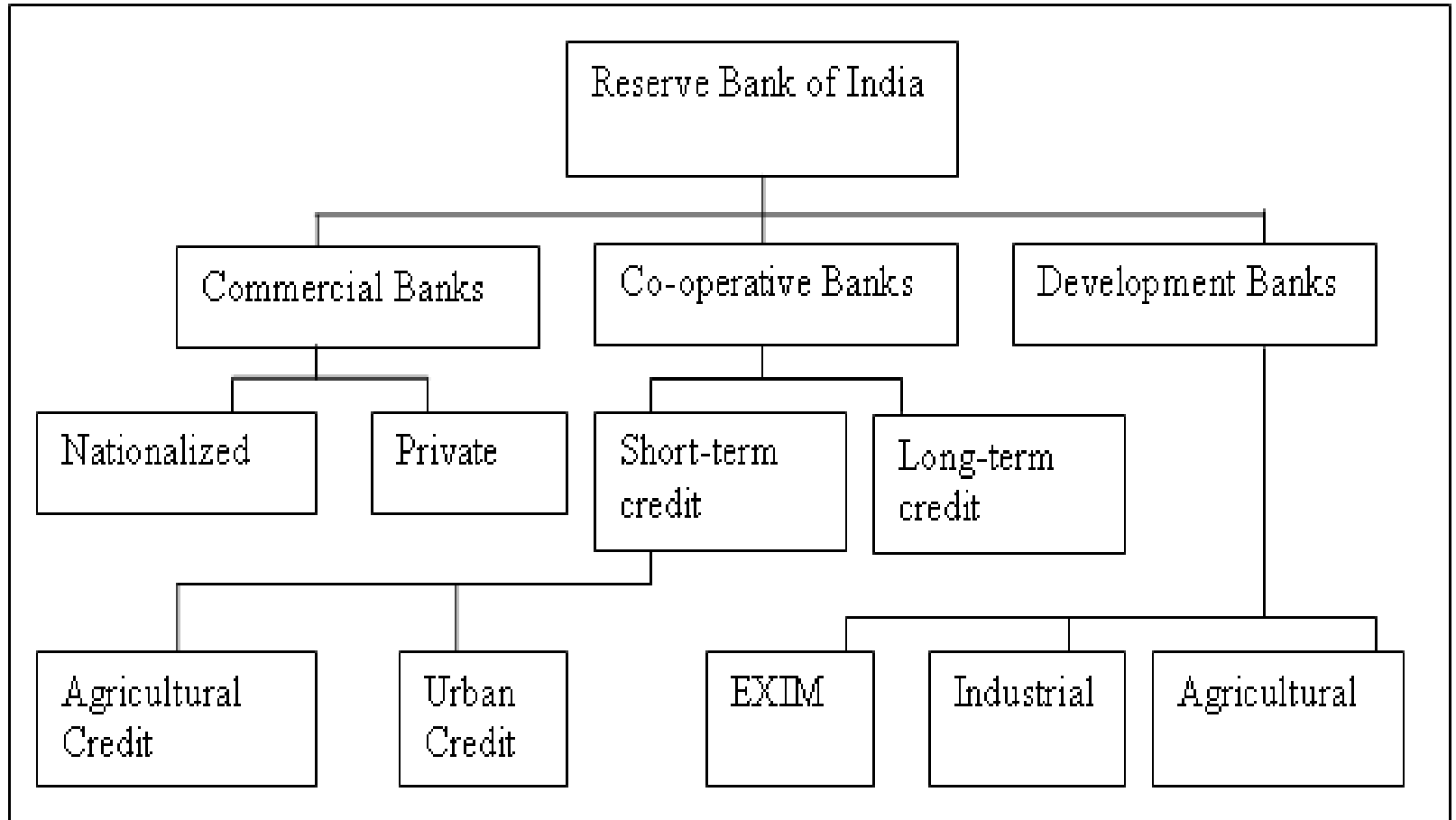
Banking

Banking Regulation Act of India, 1949 defines Banking as “accepting, for the purpose of lending or of investment of deposits of money from the public, repayable on demand or otherwise or withdrawable by cheque, draft order or otherwise.” The Reserve Bank of India Act, 1934 and the Banking Regulation Act, 1949, govern the banking operations in India.

Banking Structure in India

- A well-regulated banking system is a key comfort for local and foreign stake-holders in any country. Prudent banking regulation is recognized as one of the reasons why India was less affected by the global financial crisis.
- Banks can be broadly categorized as Commercial Banks or Co-operative Banks.
- Banks which meet specific criteria are included in the second schedule of the RBI Act, 1934. These are called scheduled banks. They may be commercial banks or co-operative banks. Scheduled banks are considered to be safer, and are entitled to special facilities like re-finance from RBI. Inclusion in the schedule also comes with its responsibilities of reporting to RBI and maintaining a percentage of its demand and time liabilities as Cash Reserve Ratio (CRR) with RBI.

Structure of Banks in India



Broad Classification of Banks in India

1) **The RBI:** The RBI is the supreme monetary and banking authority in the country and has the responsibility to control the banking system in the country. It keeps the reserves of all scheduled banks and hence is known as the “Reserve Bank”.

2) **Public Sector Banks:**

- State Bank of India and its Associates (8)
- Nationalized Banks (19)
- Regional Rural Banks Sponsored by Public Sector Banks (196)

3) **Private Sector Banks:**

- Old Generation Private Banks (22)
- Foreign New Generation Private Banks (8)
- Banks in India (40)

4) Co-operative Sector Banks:

- State Co-operative Banks
- Central Co-operative Banks
- Primary Agricultural Credit Societies
- Land Development Banks
- State Land Development Banks

5) Development Banks: Development Banks mostly provide long term finance for setting up industries. They also provide short-term finance (for export and import activities)

- Industrial Finance Co-operation of India (IFCI)
- Industrial Development of India (IDBI)
- Industrial Investment Bank of India (IIBI)
- Small Industries Development Bank of India (SIDBI)
- National Bank for Agriculture and Rural Development (NABARD)
- Export-Import Bank of India

Commercial Banks

- Commercial banks comprising public sector banks, foreign banks, and private sector banks represent the most important financial intermediary in the Indian financial system.

The changes in banking structure and control have resulted due to wider geographical spread and deeper penetration of rural areas, higher mobilization of deposits, reallocation of bank credit to priority activities, and lower operational autonomy for a bank management. Public sector commercial banks, dominate the commercial banking scene in the country. The largest commercial Banks in India is SBI

Main function of commercial banks

A) Acceptance of deposits

- Fixed deposit account
- Saving bank account
- Current account

B) Advancing of loan

- Cash credit
- Call loans
- Over draft
- Bills discounting

Main function of commercial banks

cont-

C) Agency function

- Collecting receipts
- Making payments
- Buy and sell securities
- Trustee and executor

D) General utility function

- Issuing letters of credit, travelers cheques
- Underwriting share and debentures
- Safe custody of valuables
- Providing ATM and credit card facilities
- Providing credit information

Cooperative Bank

- These banks play a vital role in mobilizing savings and stimulating agricultural investment. Co-operative credit institutions account for the second largest proportion of 44.6% of total institutional credit. The co-operative sector is very much useful for rural people. The co-operative banking sector is divided into the following categories.
- State co-operative Banks
- Central co-operative banks
- Primary Agriculture Credit Societies

Development Banks

- A development bank may be defined as a financial institution concerned with providing all types of financial assistance to business units in the form of loans, underwriting, investment and guarantee operations and promotional activities-economic development in general and industrial development in particular
- A development bank is basically a term lending institution. It is a multipurpose financial institution with a broad development outlook.
- The industrial finance corporation of India, the first development bank was established in 1948. Subsequently many other institutions were set-up. Ex. IDBI, IFCI, SIDBI etc.

Functions of Development Banks

- Fostering industrial growth
- Providing Long term assistant
- Balanced development
- Providing Promotional services
- Infrastructure building
- Entrepreneur Development
- Fulfilling Socio economic objectives

Investment Banks

- **Meaning:** Financial intermediaries that acquire the savings of people and direct these funds into the business enterprises seeking capital for the acquisition of plant and equipment and for holding inventories are called 'investment banks'.
- **Features:** Long term financing, Security, merchandiser, Security middlemen, Insurer, Underwriter
- **Functions:** Capital formation, Underwriting, Purchase of securities, Selling of securities, Advisory services, Acting as dealer.

Merchant Banks

- **Meaning:** Institution that render wide range of services such as the management of customer's securities, portfolio management, counseling, insurance, etc are called 'Merchant Banks'.
- **Functions:** Sponsoring issues, Loan syndication, Servicing of issues, Portfolio, management, Arranging fixed deposits, Helps in merger& acquisition

List of commercial banks

Public sector bank

State Bank of India

Punjab & Sind Bank

Dena Bank

Bank of Maharashtra

Allahabad Bank

Punjab National Bank

Indian Bank

Canara Bank

Andhra Bank

Syndicate Bank

Indian Overseas Bank

Central Bank of India

Bank of Baroda

Union Bank of India

Oriental Bank of Commerce

Corporation Bank

Bank of India

United Bank of India

IDBI Bank

UCO Bank

Vijaya Bank

Indian private banks

- *Axis Bank
- *Bank of Rajasthan
- *Bharat Overseas Bank
- *Catholic Syrian Bank
- *Centurion Bank of Punjab
- *City Union Bank
- *Development Credit Bank
- *Dhanalakshmi Bank
- *Federal Bank
- *Ganesh Bank of Kurundwad
- *HDFC Bank
- *ICICI Bank
- *YES Bank
- *IndusInd Bank
- *ING Vysya Bank
- *Jammu & Kashmir Bank
- *Karnataka Bank Limited
- *Karur Vysya Bank
- *Kotak Mahindra Bank
- *Lakshmi Vilas Bank
- *Nainital Bank
- *Ratnakar Bank
- *SBI Commercial and International Bank
- *South Indian Bank
- *Tamilnad Mercantile Bank Ltd.

List of Foreign banks in India

- ABN-AMRO Bank
- Abu Dhabi Commercial Bank Ltd
- American Express Bank Ltd
- Citibank
- DBS Bank Ltd
- Deutsche Bank
- HSBC Ltd
- Standard Chartered Bank

The Role of Reserve Bank of India (RBI) -Banker's Bank

- The Reserve Bank of India (RBI) is the central bank of India, and was established on April 1, 1935 in accordance with the provisions of the Reserve Bank of India Act, 1934. Since its inception, it has been headquartered in Mumbai. Though originally privately owned, RBI has been fully owned by the Government of India since nationalization in 1949.
- RBI is governed by a central board (headed by a Governor) appointed by the Central Government. RBI has 22 regional offices across India. The Reserve Bank of India was set up on the recommendations of the Hilton Young Commission.

Functions of RBI

- Monetary Authority
- Formulates, implements and monitors the monetary policy.
- Objective: maintaining price stability and ensuring adequate flow of credit to productive sectors
- Regulator and supervisor of the financial system
- Prescribes broad parameters of banking operations within which the country's banking and financial system functions.
- Objective: Maintain public confidence in the system, protect depositors' interest and provide cost-effective banking services to the public. The Banking Ombudsman Scheme has been formulated by the Reserve Bank of India (RBI) for effective redressal of complaints by bank customers

Functions of RBI cont-

- Manager of Foreign Exchange and Control
- Manages the foreign exchange through Foreign Exchange Management Act, 1999.
- Objective: to facilitate external trade and payment and promote orderly development and maintenance of foreign exchange market in India.
- Issuer of currency
- Issues and exchanges or destroys currency and coins not fit for circulation.
- Objective: to give the public adequate quantity of supplies of currency notes and coins and in good quality

Functions of RBI cont-

- Developmental role
- Performs a wide range of promotional functions to support national objectives
- Related Functions
- Banker to the Government: performs merchant banking function for the central and the state governments; also acts as their banker.
- Banker to banks: maintains banking accounts of all scheduled banks.
- Owner and operator of the depository (SGL) and exchange (NDS) for government bonds

Functions of RBI cont-

- Supervisory Functions:
- In addition to its traditional central functions, the Reserve bank has certain non-monetary functions of the nature of supervision of banks and promotion of sound banking in India.
- The Reserve Bank Act, 1934, and the Banking Regulation Act, 1949 have given the RBI wide powers of supervision and control over commercial and cooperative banks, relating to licensing and establishments, branch expansion, liquidity of their assets, management and methods of working, amalgamation, reconstruction and liquidation.
- The RBI is authorized to carry out periodical inspections of the banks and to call for returns and necessary information from them.. The supervisory functions of the RBI have helped a great deal in improving the standard of banking in India to develop on sound lines and to improve the methods of their operation.

Functions of RBI cont-

- Promotional Functions:

The Reserve Bank now performs a variety of developmental and promotional functions. The Reserve Bank promotes banking habit, extend banking facilities to rural and semi-urban areas, and establish and promote new specialized financing agencies.

The Reserve bank has helped in the setting up of the IFCI and the SFC: it set up the Deposit Insurance Corporation of India in 1963 and the Industrial Reconstruction Corporation of India in 1972. These institutions were set up directly or indirectly by the Reserve Bank to promote saving habit and to mobilize savings, and to provide industrial finance as well as agricultural finance.

The RBI set up the Agricultural Credit Department in 1935 to provide agricultural credit. The Bank has developed the co-operative credit movement to encourage saving, to eliminate money-lenders from the villages and to route its short term credit to agriculture. The RBI has set up the Agricultural Refinance and Development Corporation to provide long-term finance to farmers

Products and Services offered by Banks

- The different products in a bank can be broadly classified into:
- Retail Banking
- Trade Finance
- Treasury Operations.
- Retail Banking and Trade finance operations are conducted at the branch level while the wholesale banking operations, which cover treasury operations, are at the head office or a designated branch.

Retail Banking:

- Deposits
- Loans, Cash Credit and Overdraft
- Negotiating for Loans and advances
- Remittances
- Book-Keeping (maintaining all accounting records)
- Receiving all kinds of bonds valuable for safe keeping

Trade Finance:

- Issuing and confirming of letter of credit.
- Drawing, accepting, discounting, buying, selling, collecting of bills of exchange, promissory notes, drafts, bill of lading and other securities.

- **Treasury Operations:**

- Buying and selling of bullion. Foreign exchange
- Acquiring, holding, underwriting and dealing in shares, debentures, etc.
- Purchasing and selling of bonds and securities on behalf of constituents.
- The banks can also act as an agent of the Government or local authority. They insure, guarantee, underwrite, participate in managing and carrying out issue of shares, debentures, etc.
- Apart from the above-mentioned functions of the bank, the bank provides a whole lot of other services like investment counseling for individuals, short-term funds management and portfolio management for individuals and companies. It undertakes the inward and outward remittances with reference to foreign exchange and collection of varied types for the Government

Common Banking Products Available:

- **Credit Card:** Credit Card is “post paid” or “pay later” card that draws from a credit line-money made available by the card issuer (bank) and gives one a grace period to pay. If the amount is not paid full by the end of the period, one is charged interest
- **Debit Cards:** Debit Card is a “prepaid” or “pay now” card with some stored value. Debit Cards quickly debit or subtract money from one’s savings account, or if one were taking out cash.

Every time a person uses the card, the merchant who in turn can get the money transferred to his account from the bank of the buyers, by debiting an exact amount of purchase from the card. To get a debit card along with a Personal Identification Number (PIN).

- **Automatic Teller Machine:** The ATM's are used by banks for making the customers dealing easier. ATM card is a device that allows customer who has an ATM card to perform routine banking transaction at any time without interacting with human teller. It provides exchange services. This service helps the customer to withdraw money even when the banks are closed. This can be done by inserting the card in the ATM and entering the Personal Identification Number and secret Password. It allows the customers
 - To transfer money to and from accounts.
 - To view account information.
 - To order cash.
 - To receive cash.

- **Electronic Funds Transfer (EFT):**. The system called electronic fund transfer (EFT) automatically transfers money from one account to another. This system facilitates speedier transfer of funds electronically from any branch to any other branch. In this system the sender and the receiver of funds may be located in different cities and may even bank with different banks. Funds transfer within the same city is also permitted. The scheme has been in operation since February 7, 1996, in India.
- **Telebanking:** Telebanking refers to banking on phone services. A customer can access information about his/her account through a telephone call and by giving the coded Personal Identification Number (PIN) to the bank. Telebanking is extensively user friendly and effective in nature.

- **Mobile Banking:** A new revolution in the realm of e-banking is the emergence of mobile banking. On-line banking is now moving to the mobile world, giving everybody with a mobile phone access to real-time banking services, regardless of their location. It provides a new way to pick up information and interact with the banks to carry out the relevant banking business. The potential of mobile banking is limitless and is expected to be a big success. Booking and paying for travel and even tickets is also expected to be a growth area. This is a very flexible way of transacting banking business.

- **Internet Banking:** Internet banking involves use of internet for delivery of banking products and services. Banking is no longer confined to the branches where one has to approach the branch in person, to withdraw cash or deposits a cheque or request a statement of accounts. In internet banking, any inquiry or transaction is processed online without any reference to the branch (anywhere banking) at any time.
- **Benefits of Internet Banking:**
- Reduce the transaction costs of offering several banking services and diminishes the need for longer numbers of expensive brick and mortar branches and staff.
- Increase convenience for customers, since they can conduct many banking transaction 24 hours a day.
- Increase customer loyalty.
- Improve customer access.
- Attract new customers.
- Easy online application for all accounts, including personal loans and mortgages

Banking Services

- Banking covers many services, these basic services have always been recognized as the hallmark of the genuine banker. These are...
- The receipt of the customer's deposits
- The collection of cheques drawn on other banks
- The payment of the customer's cheques drawn on himself
- **There are other various types of banking services like:**
 - Advances – Overdraft, Cash Credit, etc.
 - Deposits – Saving Account, Current Account, etc.
 - Financial Services – Bill discounting etc.
 - Foreign Services – Providing foreign currency, travelers cheques, etc.
 - Money Transmission – Funds transfer etc.
 - Savings – Fixed deposits, etc.
 - Services of place or time – ATM Services.
 - Status – Debit Cards, Credit Cards, etc.

Bank Lending

- Banks extend credit to different categories of borrowers for a wide variety of purposes. Bank credit is provided to households, retail traders, small and medium enterprises (SMEs), corporates, the Government undertakings etc. in the economy.
- Retail banking loans are accessed by consumers of goods and services for financing the purchase of consumer durables, housing or even for day-to-day consumption. In contrast, the need for capital investment, and day-to-day operations of private corporates and the Government undertakings are met through wholesale lending.
- Loans for capital expenditure are usually extended with medium and long-term maturities, while day-to-day finance requirements are provided through short-term credit (working capital loans). Meeting the financing needs of the agriculture sector is also an important role that Indian banks play.

Principles of lending

- **Safety:** Banks need to ensure that advances are safe and money lent out by them will come back. Since the repayment of loans depends on the borrowers' capacity to pay, the banker must be satisfied before lending that the business for which money is sought is a sound one. In addition, bankers many times insist on security against the loan, which they fall back on if things go wrong for the business. The security must be adequate, readily marketable and free of encumbrances.
- **Liquidity:** To maintain liquidity, banks have to ensure that money lent out by them is not locked up for long time by designing the loan maturity period appropriately. Further, money must come back as per the repayment schedule. If loans become excessively illiquid, it may not be possible for bankers to meet their obligations vis-à-vis depositors.

- **Profitability:** To remain viable, a bank must earn adequate profit on its investment. This calls for adequate margin between deposit rates and lending rates. In this respect, appropriate fixing of interest rates on both advances and deposits is critical. Unless interest rates are competitively fixed and margins are adequate, banks may lose customers to their competitors and become unprofitable.
- **Risk diversification:** To mitigate risk, banks should lend to a diversified customer base. Diversification should be in terms of geographic location, nature of business etc.

Loan Policy

- Based on the general principles of lending stated above, the Credit Policy Committee (CPC) of individual banks prepares the basic credit policy of the Bank, which has to be approved by the Bank's Board of Directors.
- The loan policy outlines lending guidelines and establishes operating procedures in all aspects of credit management including standards for presentation of credit proposals, rating standards and benchmarks, delegation of credit approving powers, prudential limits on large credit exposures, asset concentrations, portfolio management, loan review mechanism, risk monitoring and evaluation, pricing of loans, provisioning for bad debts, regulatory/legal compliance etc
- The loan policy typically lays down lending guidelines in the following areas:
 - Level of credit-deposit ratio
 - Targeted portfolio mix
 - Ratings
 - Loan pricing
 - Collateral security

Loan Policy cont-

- **Credit Deposit (CD) Ratio:** A bank can lend out only a certain proportion of its deposits, since some part of deposits have to be statutorily maintained as Cash Reserve Ratio (CRR) deposits, and an additional part has to be used for making investment in prescribed securities (Statutory Liquidity Ratio or SLR requirement). It may be noted that these are minimum requirements. Banks have the option of having more cash reserves than CRR requirement and invest more in SLR securities than they are required to.
- **Targeted Portfolio Mix:** The CPC aims at a targeted portfolio mix keeping in view both risk and return. Toward this end, it lays down guidelines on choosing the preferred areas of lending (such as sunrise sectors and profitable sectors) as well as the sectors to avoid. Banks typically monitor all major sectors of the economy. They target a portfolio mix in the light of forecasts for growth and profitability for each sector. If a bank perceives economic weakness in a sector, it would restrict new exposures to that segment and similarly, growing and profitable sectors of the economy prompt banks to increase new exposures to those sectors. This entails active portfolio management.

Loan Policy cont-

- **Ratings:** There are a number of diverse risk factors associated with borrowers. Banks should have a comprehensive risk rating system that serves as a single point indicator of diverse risk factors of a borrower. This helps taking credit decisions in a consistent manner.
- **Pricing of loans:** Risk-return trade-off is a fundamental aspect of risk management. Borrowers with weak financial position are placed in higher risk category and are provided credit facilities at a higher price (that is, at higher interest). The higher the credit risk of a borrower the higher would be his cost of borrowing. To price credit risks, banks devise appropriate systems, which usually allow flexibility for revising the price (risk premium) due to changes in rating. In other words, if the risk rating of a borrower deteriorates, his cost of borrowing should rise and vice versa

Loan Policy cont-

- **Collateral security:** As part of a prudent lending policy, banks usually advance loans against some security. The loan policy provides guidelines for this. In the case of term loans and working capital assets, banks take as 'primary security' the property or goods against which loans are granted. In addition to this, banks often ask for additional security or 'collateral security' in the form of both physical and financial assets to further bind the borrower. This reduces the risk for the bank
- **Capital adequacy:** The amount of capital they have to be backed up by depends on the risk of individual assets that the bank acquires. The riskier the asset, the larger would be the capital it has to be backed up by. A key norm of Capital Adequacy Ratio (CAR) known as Capital Risk Weighted Assets Ratio, is a simple measure of the soundness of a bank. The ratio is the capital with the bank as a percentage of its risk-weighted assets. Given the level of capital available with an individual bank, this ratio determines the maximum extent to which the bank can lend.

Loan Policy cont-

- **Credit Exposure Limits:** As a prudential measure aimed at better risk management and avoidance of concentration of credit risks, the Reserve Bank has fixed limits on bank exposure to the capital market as well as to individual and group borrowers with reference to a bank's capital. Limits on inter-bank exposures have also been placed. Banks are further encouraged to place internal caps on their sectorial exposures, their exposure to commercial real estate and to unsecured exposures. These exposures are closely monitored by the Reserve Bank.
- **Lending Rates:** Banks are free to determine their own lending rates on all kinds of advances except a few such as export finance; interest rates on these exceptional categories of advances are regulated by the RBI. The concept of benchmark prime lending rate (BPLR) was introduced in November 2003 for pricing of loans by commercial banks with the objective of enhancing transparency in the pricing of their loan products. Each bank must declare its benchmark prime lending rate (BPLR) to the Reserve Bank.

Types of Advances(Lending)

Universal Banking Services

- Advances can be broadly classified into Fund-based lending and Non-fund based lending
- **Fund based lending:** This is a direct form of lending in which a loan with an actual cash outflow is given to the borrower by the Bank. In most cases, such a loan is backed by primary and/or collateral security. The loan can be to provide for financing capital goods and/or working capital requirements etc.
- **Non-fund based lending:** These are services, where there is no outlay of funds by the bank when the commitment is made. At a later stage however, the bank may have to make funds available. Since there is no fund outflow initially, it is not reflected in the balance sheet. However, the bank may have to pay. Therefore, it is reflected as a *contingent liability in the Notes to the Balance Sheet*. Therefore, such exposures are called *Off Balance Sheet Exposures*. When the commitment is made, the bank charges a fee to the customer. Therefore, it is also called *fee-based business*..

Fund-based Services (Lending) for Business

- **Working Capital Finance:** Working capital finance is utilized for operating purposes, resulting in creation of current assets (such as inventories and receivables). Banks carry out a detailed analysis of borrowers' working capital requirements. Credit limits are established in accordance with the process approved by the board of directors. The limits on Working capital facilities are primarily secured by inventories and receivables (chargeable current assets). Working capital finance consists mainly of cash credit facilities, short term loan and bill discounting.
- **Project Finance:** Project finance business consists mainly of extending medium-term and long-term rupee and foreign currency loans to the manufacturing and infrastructure sectors. Banks also provide financing by way of investment in marketable instruments such as fixed rate and floating rate debentures. Lending banks usually insist on having a first charge on the fixed assets of the borrower. The project finance approval process entails a detailed evaluation of technical, commercial, financial and management factors and the project sponsor's financial strength and experience.

- **Loans to Small and Medium Enterprises:** A substantial quantum of loans is granted by banks to small and medium enterprises (SMEs). While granting credit facilities to smaller units, banks often use a cluster-based approach, which encourages financing of small enterprises that have a homogeneous profile such as leather manufacturing units, chemical units, or even export oriented units
- **Bank Overdraft :** A facility where the account holder is permitted to draw more funds than the amount in his current account.

- **Bill Purchase / Discount** – When Party A supplies goods to Party B, the payment terms may provide for a Bill of Exchange (traditionally called hundi). A bill of exchange is an unconditional written order from one person (the supplier of the goods) to another (the buyer of the goods), signed by the person giving it (supplier), requiring the person to whom it is addressed (buyer) to pay on demand or at some fixed future date, a certain sum of money, to either the person identified as payee in the bill of exchange, or to any person presenting the bill of exchange.
- When payable on demand, it is a Demand Bill
- When payable at some fixed future date, it is a Usance Bill.
- The supplier of the goods can receive his money even before the buyer makes the payment, through a Bill Purchase / Discount facility with his banker.
- It would operate as follows:
- The supplier will submit the Bill of Exchange, along with Transportation Receipt to his bank.
- The supplier's bank will purchase the bill (if it is a demand bill) or discount the bill (if it is a usance bill) and pay the supplier.
- The supplier's bank will send the Bill of Exchange along with Transportation Receipt to the buyer's bank, who is expected to present it to the buyer:
- For payment, if it is a demand bill
- For acceptance, if it is a usance bill.
- The buyer will receive the Transportation Receipt only on payment or acceptance, as the case may be.

Fund-based Services (Lending) for Individuals

- **Credit Card** : The customer swipes the credit card to make his purchase. His seller will then submit the details to the card issuing bank to collect the payment. The bank will deduct its margin and pay the seller. The bank will recover the full amount from the customer (buyer). The margin deducted from the seller's payment thus becomes a profit for the card issuer.
- **Personal Loans**: These are often unsecured loans provided to customers who use these funds for various purposes such as higher education, medical expenses, social events and holidays. Sometimes collateral security in the form of physical and financial assets may be available for securing the personal loan

- **Vehicle Finance** : This is finance which is made available for the specific purpose of buying a car or a two-wheeler or other automobile. The interest rate for used cards can go close to the personal loan rates. However, often automobile manufacturers work out special arrangements with the financiers to promote the sale of the automobile. This makes it possible for vehicle-buyers to get attractive financing terms for buying new vehicles.
- **Home Finance:** Banks extend home finance loans, either directly or through home finance subsidiaries. Such long term housing loans are provided to individuals and corporations and also given as construction finance to builders. The loans are secured by a mortgage of the property financed. These loans are extended for maturities generally ranging from five to fifteen years and a large proportion of these loans are at floating rates of interest

Non-Fund-based Services For Business

- **Letter of Credit** : When Party A supplies goods to Party B, the payment terms may provide for a Letter of Credit.
- In such a case, Party B (buyer, or opener of L/C) will approach his bank (L/C Issuing Bank) to pay the beneficiary (seller) the value of the goods, by a specified date, against presentment of specified documents. The bank will charge the buyer a commission, for opening the L/C.
- The L/C thus allows the Part A to supply goods to Party B, without having to worry about Party B's credit-worthiness. It only needs to trust the bank that has issued the L/C. It is for the L/C issuing bank to assess the credit-worthiness of Party B. Normally, the L/C opener has a finance facility with the L/C issuing bank.
- The L/C may be inland (for domestic trade) or cross border (for international trade).

- **Guarantee:** In business, parties make commitments. The beneficiary of the commitment wants to be sure that the party making the commitment (obligor) will live up to the commitment. This comfort is given by a guarantor, whom the beneficiary trusts.
- Banks issue various guarantees in this manner, and recover a guarantee commission from the obligor. The guarantees can be of different kinds, such as Financial Guarantee, Deferred Payment Guarantee and Performance Guarantee, depending on how they are structured
- **Loan Syndication:** This investment banking role is performed by a number of universal banks

Non-Fund-based Services For Individuals

- Sale of Financial Products such as mutual funds and insurance is another major service offered by universal banks.
- Financial Planning and Wealth Management are offered by universal banks.
- Executors and Trustees: a department within banks – help customers in managing succession of assets to the survivors or the next generation.
- Lockers: a facility that most Indian households seek to store ornaments and other
- valuables

Money Remittance Services

- **Demand Draft / Banker's Cheque / Pay Order**
- **National Electronic Funds Transfer (NEFT):** National Electronic Funds Transfer (NEFT) is a nation-wide system that facilitates individuals, firms and corporates to electronically transfer funds from any bank branch to any individual, firm or corporate having an account with any other bank branch in the country.
- In order to issue the instruction, the transferor should know not only the beneficiary's bank account number but also the IFSC (Indian Financial System Code) of the concerned bank.
- IFSC is an alpha-numeric code that uniquely identifies a bank-branch participating in the NEFT system. This is a 11 digit code with the first 4 alpha characters representing the bank, and the last 6 numeric characters representing the branch. The 5th character is 0 (zero). IFSC is used by the NEFT system to route the messages to the destination banks / branches

- **Real Time Gross Settlement (RTGS):** RTGS transfers are instantaneous unlike National Electronic Funds Transfer (NEFT) where the transfers are batched together and effected at hourly intervals. RBI allows the RTGS facility for transfers above Rs1lakhs. The RBI window is open on weekdays from 9 am to 4.30 pm; on Saturdays from 9 am to 12.30 pm
- **Society for Worldwide Interbank Financial Telecommunications (SWIFT):** SWIFT is solely a carrier of messages. It does not hold funds nor does it manage accounts on behalf of customers, nor does it store financial information on an on-going basis. As a data carrier, SWIFT transports messages between two financial institutions. This activity involves the secure exchange of proprietary data while ensuring its confidentiality and integrity.
- SWIFT, which has its headquarters in Belgium, has developed an 8-alphabet Bank Identifier Code (BIC). The BIC helps identify the bank

Non Performing Assets

- An asset of a bank (such as a loan given by the bank) turns into a non-performing asset (NPA) when it ceases to generate regular income such as interest etc for the bank.
- In other words, when a bank which lends a loan does not get back its principal and interest on time, the loan is said to have turned into an NPA
- Banks have to classify their assets as performing and non-performing in accordance with RBI's guidelines. Under these guidelines, an asset is classified as non-performing if any amount of interest or principal installments remains overdue for more than 90 days, in respect of term loans. In respect of overdraft or cash credit, an asset is classified as non-performing if the account remains out of order for a period of 90 days and in respect of bills purchased and discounted account, if the bill remains overdue for a period of more than 90 days.

Classification of non-performing Assets

- **Standard assets:** Standard assets service their interest and principal installments on time although they occasionally default up to a period of 90 days. Standard assets are also called performing assets. They yield regular interest to the banks and return the due principal on time and thereby help the banks earn profit and recycle the repaid part of the loans for further lending.
- **Sub-standard assets:** Sub-standard assets are those assets which have remained NPAs (that is, if any amount of interest or principal installments remains overdue for more than 90 days) for a period up to 12 months

- **Doubtful assets:** An asset becomes doubtful if it remains a sub-standard asset for a period of 12 months and recovery of bank dues is of doubtful
- **Loss assets:** Loss assets comprise assets where a loss has been identified by the bank or the RBI. These are generally considered uncollectible. Their realizable value is so low that their continuance as bankable assets is not warranted. They should be entirely written off. If this is not done, provisioning should be made for 100% of the amount shown as outstanding

SARFAESI Act

- Banks utilize the Securitization and Reconstruction of Financial Assets and Enforcement of Security Interest Act, 2002 (SARFAESI) as an effective tool for NPA recovery. It is possible where non-performing assets are backed by securities charged to the Bank by way of hypothecation or mortgage or assignment. Upon loan default, banks can seize the securities (except agricultural land) without intervention of the court.
- The SARFAESI Act, 2002 gives powers of "seize and desist" to banks. Banks can give a notice in writing to the defaulting borrower requiring it to discharge its liabilities within 60 days. If the borrower fails to comply with the notice, the Bank may take recourse to one or more of the following measures:
 - Take possession of the security for the loan
 - Sale or lease or assign the right over the security
 - Manage the same or appoint any person to manage the same
- The SARFAESI Act also provides for the establishment of asset reconstruction companies regulated by RBI to acquire assets from banks and financial institutions.
- The Act provides for sale of financial assets by banks and financial institutions to asset reconstruction companies (ARCs). RBI has issued guidelines to banks on the process to be followed for sales of financial assets to ARCs.

- **Hypothecation:** Hypothecation is defined under the SARFAESI Act, 2002, (which will be discussed in the next chapter) as follows:
- Hypothecation means a charge in or upon any movable property, existing or future, created by a borrower in favour of a secured creditor, without delivery of possession of the moveable property to such creditor, as a security for financial assistance, and includes floating charge and crystallization of such charge into fixed charge on moveable property.

- The act addresses the regulation of three distinct areas:
- Securitization
- Reconstruction of Financial Assets
- Enforcement of Security Interest

Securitization

- This is a process where financial assets (say, dues from a borrower) are converted into marketable securities (security receipts) that can be sold to investors.
- In the first stage of a securitization transaction, an originator sells the financial asset to the securitization company. This can be done as follows:
- The securitization company / asset re-construction company issues a debenture or bond or any other security in the nature of a debenture, for the agreed consideration, and as per the agreed terms and conditions, to the originator; or
- Entering into an agreement for transfer of the financial asset as per the agreed terms and conditions
- On acquisition of the financial asset, the securitization or reconstruction company becomes the owner of the financial asset

- In the second stage, against the security of the financial asset, the securitization company can mobilize money by issuing security receipts to QIB investors.
- Thus, securitization makes it possible to transfer loans secured by mortgage or other charges.

Asset Re-construction

- Here, the right or interest of any bank or financial institution in any financial asset is acquired by the asset re-construction company for the purpose of realization of dues.
- Asset re-construction might entail taking several measures such as:
- Takeover the management of the business of the borrower or bring about any such change.
- To sell or lease a part or whole of the business of the borrower.
- Reschedule debts of the borrower.
- Take possession of secured asset
- Enforce security interest
- Settle dues payable by the borrower

- **Enforcement of Security Interest**
- SARFAESI gives another window for banks and financial institutions to enforce their security interest without the intervention of Civil Court or the Debt Recovery Tribunal (DRT).
- If the lender also holds security through a pledge of any moveable assets, or the guarantee of any person, then it can sell the pledged goods or proceed against the guarantor without initiating any action against the secured assets.
- Under SARFAESI, the bank or financial institution needs to give 60-day notice to the defaulter, giving details of the amount payable and the secured asset intended to be enforced by the secured creditor, in the event of non-payment of the secured debt. The effect of this notice is that the borrower is barred from transferring the property mentioned in the notice.

- If the dues are not paid during the notice period, then the secured creditor gets the following rights:
- Take possession of the secured assets, and transfer it by lease, assignment or sale for realization of money.
- Appoint a manager to manage the secured assets that have been re-possessed.
- Takeover management of the secured assets, and transfer it by lease, assignment or sale for realization of money.
- Give notice to any person who has acquired the secured asset from the borrower, and from whom any money is due or may become due to the borrower, to pay the moneys to the secured creditor. Such payment to the secured creditor will be a valid discharge of the person's dues to the borrower

International Banking

- International banking relates to financial intermediaries that bid for time deposits and make loans in the offshore market
- It is an unregulated market involving greater risk
- It is a wholesale segment of lending and deposit activity
- International banking brings together borrowers and lenders from same country or different countries
- They are substitutes for the domestic banking system

Major Functions of International Banking

1. Facilitate imports and exports of their clients – trade financing
2. Arrange for foreign exchange – cross-border transactions and foreign investments
3. Assist in hedging exchange rate risk
4. Trade foreign exchange products for their own account
5. Borrow and lend in the Eurocurrency market
6. Participate in international loan syndicate – lending to MNCs- project financing and to sovereign governments – economic development
7. Participate in underwriting of Eurobonds and foreign bonds issues.
8. Provide consultancy and advice on hedging strategies, interest rate and currency swap financing and international cash management services

BASEL Framework

- **Bank for International Settlements (BIS)**
- Established on 17 May 1930, the BIS is the world's oldest international financial organization. It has its head office in Basel, Switzerland.
- BIS fosters co-operation among central banks and other agencies in pursuit of monetary and financial stability. It fulfills this mandate by acting as:
 - A forum to promote discussion and policy analysis among central banks and within the international financial community
 - A centre for economic and monetary research
 - A prime counterparty for central banks in their financial transactions
 - Agent or trustee in connection with international financial operations

- Every two months, the BIS hosts in Basel, meetings of Governors and senior officials of member central banks. The meetings provide an opportunity for participants to discuss the world economy and financial markets, and to exchange views on topical issues of central bank interest or concern.
- BIS also organizes frequent meetings of experts on monetary and financial stability issues, as well as on more technical issues such as legal matters, reserve management, IT systems, internal audit and technical cooperation.
- BIS is a hub for sharing statistical information among central banks. It publishes statistics on global banking, securities, foreign exchange and derivatives markets.
- Through seminars and workshops organized by its Financial Stability Institute (FSI), the BIS disseminates knowledge among its various stake-holders

Role Of Information Technology (It) In The Banking Sector

- Banking environment has become highly competitive today. To be able to survive and grow in the changing market environment banks are going for the latest technologies, which is being perceived as an 'enabling resource' that can help in developing learner and more flexible structure that can respond quickly to the dynamics of a fast changing market scenario.
- It is also viewed as an instrument of cost reduction and effective communication with people and institutions associated with the banking business.
- Information Technology enables sophisticated product development, better market infrastructure, implementation of reliable techniques for control of risks and helps the financial intermediaries to reach geographically distant and diversified markets.

E-Banking

- Many banks have modernized their services with the facilities of computer and electronic equipments.
- The electronics revolution has made it possible to provide ease and flexibility in banking operations to the benefit of the customer.
- The e-banking has made the customer say good-bye to huge account registers and large paper bank accounts

- The e-banks, which may call as easy bank offers the following services to its customers
- Credit Cards – Debit Cards
- ATM
- E-Cheques
- EFT (Electronic Funds Transfer)
- D-MAT Accounts
- Mobile Banking
- Telephone Banking
- Internet Banking
- EDI (Electronic Data Interchange)

Benefits of E-banking

To the Customer

- Anywhere Banking no matter wherever the customer is in the world. Balance enquiry, request for services, issuing instructions etc., from anywhere in the world is possible.
- Anytime Banking – Managing funds in real time and most importantly, 24 hours a day, 7days a week.
- Convenience acts as a tremendous psychological benefit all the time.
- Brings down “Cost of Banking” to the customer over a period a period of time.
- Cash withdrawal from any branch / ATM
- On-line purchase of goods and services including online payment for the same.

To the Bank:

- Innovative, scheme, addresses competition and present the bank as technology driven in the banking sector market .
- Reduces customer visits to the branch and thereby human intervention
- Inter-branch reconciliation is immediate thereby reducing chances of fraud and misappropriation
- On-line banking is an effective medium of promotion of various schemes of the bank, a marketing tool indeed.
- Integrated customer data paves way for individualized and customized services.