Class: B.Com-5thSemester

Banking Service Management

I.K.G. Punjab Technical University
Bachelor of Commerce (Hons.) Batch 2018 onwards
BCOP 521-18
Banking Services Management

Objective: The course offers to the candidates the knowledge of different aspects of Banking along with thorough understanding of the practical application of the theory. The paper aims at acquainting the students, the concepts of Banking services and relevant aspects.

UNIT – I

Bank: Definition, importance and functions. **Indian Banking System**; Structure and organization and services provided by Banks: Commercial Banks; Regional Rural Banks; cooperative Banks. Functions of a Bank in an Economic development

UNIT – II

The Reserve Bank of India: Management and Structure, Functions of RBI, Monetary Policies and Techniques of Credit Control. **Reforms in Indian Banking**: Overview, Recommendations of Narasimham Committee, Verma Panel Report, Basel II Norms, Capital Adequacy Ratio (CAR), Revised NPA Norms- Grievance Mechanism and Banking Ombudsman, Impact of Reforms.

UNIT – III

Emerging Trends in Banking: Concept of E-Banking, Mobile Banking, Electronic Fund Transfer- (RTGS & NEFT) Core Banking Wholesale and Retail Banking, Universal and Narrow Banking, Off-shore Banking. Asset Classification, RBI Guidelines on Internet Banking, **Challenges faced by Indian Banking**, Cheque Truncation System.

UNIT IV

Interest Rate Risk Management in Banks, credit risk, **Liquidity management**, Operational Risk Management in Banks, Market Risk Management in Banks, Capital Adequacy of Banks, and Issues in Bank Management, Investment Banking and Other Services. **Analysis of Bank Statements**– Analysis of Balance Sheet and Profit and Loss Account – Financial Performance Analysis with Ratios.

Suggested Readings:

- Vaish, M. C. "Money, Banking and International Trade" New Age International Pvt.
- Ltd.
- Hajela, T. N. "Money, Banking and International Trade" Ane Books Pvt. Ltd.
- Seth, M. L. "Money, Banking and International Trade" Lakshmi Narayan Agarwal.
- Mishra, Jagannath "Money, Banking and International Trade" Thacker, Spink and

- Company.
- Jain T. R. " ModernBanking " V. K. Publications.

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UNIT-I

BANKING

MEANING OF BANKING

Banking means transacting business with a bank; depositing or withdrawing funds or requesting a loan etc.

The development of banking is evaluation in nature. The origin of the word bank can be traced back to the German word „Banck" and Italian word „Banco" which means heap of money. Banking is an old concept in India. It was present in ancient Vedic times. There were bankers known as „Sheth", „Shah", „Shroff" or „Chettiar" who were performing the function of bank.

Definition:- "Accepting for the purpose of lending & investment, of deposit of money from the public, repayable on demand order or otherwise and withdraw able by cheque, draft or otherwise."

FUNCTIONS OF BANKS

The main functions of banks are accepting deposit and lending loans:

A – Accepting deposits

1. Fixed deposits:- These deposits mature after a considerable long period like 1 year or more than that the rate of interest is fixed the amount deposited cannot be withdrawn before maturity date.

2. Current A/C deposit:- These are mainly maintain by business community to facilitate frequent transaction with big amounts. Generally no rate of interest or very low rate of interest is paid on this account.

3. Savings bank A/C:- It is kind of demand deposits which is generally kept by the people for the sake of safety. These facility is given for small saver and normally a small rate of interest is paid.

4. Recurring deposit A/C:- In case of recurring deposit the fixed amount is deposited in a bank every month for a fixed period of time.

B-Lending loans

1. Call loans:- These loan are called back at any time. Normally, this loans are taken by bill brokers or stock brokers.

2. Short term loans:- These are sanctioned for a period up to 1 year. **3.Medium term loans:-** These are sanctioned for the period varying between 1 and 5 years.

4. Long term loans:-These loan are sanctioned for a period of more than 5 years it includes:

1. Overdraft:- The bank grants overdraft facility to its reliable and respectable depositors. It enables companies, firms and businessmen to withdraw amount over and above their actual balance in their current account.

2. Cash credit: Under this facility, the bank allows the borrower to withdraw cash against certain security.

3. Bills of Exchange:- The bank provide funds to their customers by purchasing or discounting bills of exchange. The bank charges commission up to the maturity period of bills.

The main functions, the banks also provide financial services to the corporate sector and business and society. They are as follows:

1. Merchant Banking:- Merchant banking is an organization which underwrites securities for companies, advises in various activities. No person is allowed to carry out any activity as a Merchant Banker unless holds a certificate granted by SEBI. Thus, merchant banks are financial institutions which provide specialized services including acceptance of bills of exchange, corporate finance, portfolio management and other services.

2. Leasing:- Banks have started funding the fixed assets through leasing. It refers to the renting out of immovable property by the bank to the businessmen on a specified rent for a specific period on terms which may be mutually agreed upon. A written agreement is made in this respect.

3.Mutual funds:- The main function of mutual fund is to mobilize the savings of the general public and invest them in stock market and money market.

4. Venture Capital (VC):-Venture Capital is financial capital provided to early-stage, high-potential, high risk, growth startup companies. The venture capital fund makes money by owning equity in the companies it invests in, which usually have a novel technology or business model in high technology industries, such as biotechnology, IT, software, etc.

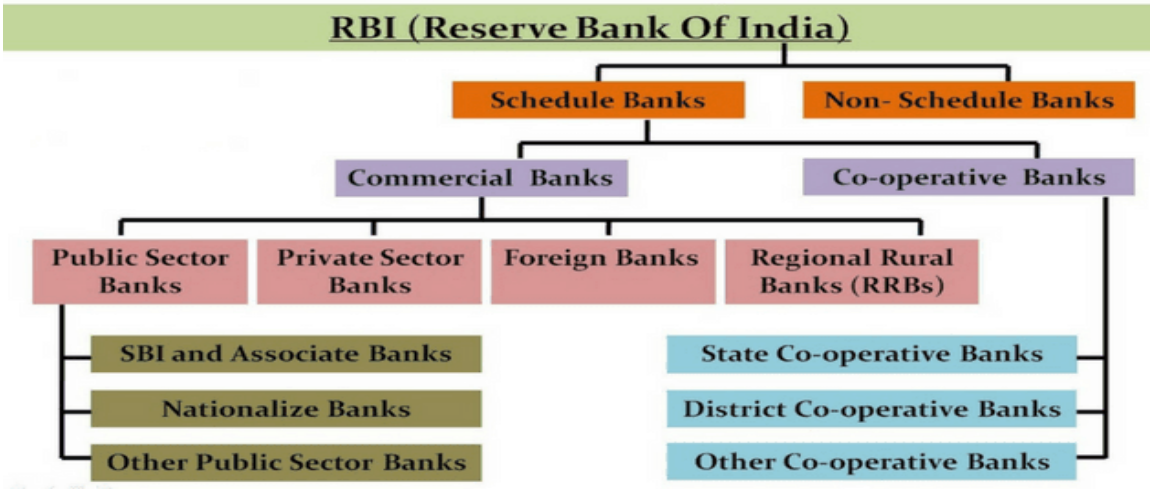
5. ATM:- An ATM is also known as cash point. The banks nowadays provide ATM facilities. The customers can withdraw money easily and quickly 24 hours a day.

6. Telebanking:- Telebanking is a throwback to the days when people would call into a central number at their bank/financial institution in order to get balance, check status and other account-related information. Most financial organizations offer telebanking services today; however, the public representation is known as telephone-based customer service or just customer service.

7. Credit cards:- Credit cards allow a person to buy goods and services up to a certain limit without immediate payment. The amount is paid to the shops, hotel, etc. by the commercial banks. 8. Locker Service:- Under this service, lockers are provided to the public in various sizes on payment of fixed rent. Customers can deposit their valuables, documents, jewellery, securities, etc. in these lockers.

8. Underwriting:- This facility is provided to the joint stock companies and to the government. The banks guarantee the purchase of certain proportion of shares, if not sold in the market.

STRUCTURE OF INDIAN BANKING SYSTEM IS AS FOLLOWS:



1. <u>Reserve Bank of India:</u>

Reserve Bank of India is the Central Bank of our country. It was established on 1st April 1935 accordance with the provisions of the Reserve Bank of India Act, 1934. It holds the apex position in the banking structure. RBI performs various developmental and promotional functions.

It has given wide powers to supervise and control the banking structure. It occupies the pivotal position in the monetary and banking structure of the country. In many countries central bank is known by different names.

For example, Federal Reserve Bank of U.S.A, Bank of England in U.K. and Reserve Bank of India in India. Central bank is known as a banker's bank. They have the authority to formulate and implement monetary and credit policies. It is owned by the government of a country and has the monopoly power of issuing notes.

2. Commercial Banks:

Commercial bank is an institution that accepts deposit, makes business loans and offer related services to various like accepting deposits and lending loans and advances to general customers and business man.

These institutions run to make profit. They cater to the financial requirements of industries and various sectors like agriculture, rural development, etc. it is a profit making institution owned by government or private of both.

Commercial bank includes public sector, private sector, foreign banks and regional rural banks:

3. Public Sector Banks:

The public sector accounts for 75 percent of total banking business in India and State Bank of India is the largest commercial bank in terms of volume of all commercial banks.

4. Private Sector Banks:

The **private-sector banks in India** represent part of the **Indian banking sector** that is made up of both **private** and public **sector banks**. The "**private-sector banks**" are **banks** where greater parts of stake or equity are held by the **private** shareholders and not by government.

List of Private Sector Banks is:

Banks	**Established**
1. Axis Bank (earlier UTI Bank)	1993(as UTI Bank)
2. Bank of Punjab (actually an old generation private bank since it was not founded under post-1993 new bank licensing regime)	
3. Centurion Bank Ltd. (Merged in Bank of Punjab in late 2005 to become Centurion Bank of Punjab, acquired by HDFC Bank Ltd. in 2008)	1994
4. Development Credit Bank (Converted from Co-operative Bank, now DCB Bank Ltd.)	1995

5. ICICI Bank (previously ICICI and then both merged;total merger SCICI+ICICI+ICICI Bank Ltd)	1996
6. IndusInd Bank	1994
7. Kotak Mahindra Bank	2003
8. Yes Bank	2005
9. Balaji Corporation Bank Limited	2010
10. HDFC bank	1994
11. Bandhan bank	2015
12. IDFC Bank	2015

5. Foreign Banks:

A foreign bank with the obligation of following the regulations of both its home and its host countries. Loan limits for these banks are based on the capital of the parent bank, thus allowing foreign banks to provide more loans than other subsidiary banks.

Foreign banks are those banks, which have their head offices abroad. CITI bank, HSBC, Standard Chartered etc. are the examples of foreign bank in India. Currently India has 36 foreign banks.

6. Regional Rural Bank (RRB):

The government of India set up Regional Rural Banks (RRBs) on October 2, 1975. The banks provide credit to the weaker sections of the rural areas, particularly the small and marginal farmers, agricultural laborers', and small entrepreneurs. There are 82 RRBs in the country. NABARD holds the apex position in the agricultural and rural development. List of some RRBs is given below:

7. Co-operative Bank:

Co-operative bank was set up by passing a co-operative act in 1904. They are organised and managed on the principal of co-operation and mutual help. The main objective of co-operative bank is to provide rural credit.

The cooperative banks in India play an important role even today in rural co-operative financing. The enactment of Co-operative Credit Societies Act, 1904, however, gave the real impetus to the movement. The Cooperative Credit Societies Act, 1904 was amended in 1912, with a view to broad basing it to enable organization of non-credit societies.

Name of some co-operative banks in India are:

1. Andhra Pradesh State Co-operative Bank Ltd

2. The Bihar State Co- operative Bank Ltd.

3. Chhattisgarh RajyaSahakari Bank Maryadit

4. The Gujarat State Co-operative Bank Ltd.

5. Haryana RajyaSahakari Bank Ltd.

Three tier structures exist in the cooperative banking:

i. State cooperative bank at the apex level.

ii. Central cooperative banks at the district level.

iii. Primary cooperative banks and the base or local level.

8. Scheduled and Non-Scheduled Banks:

The scheduled banks are those which are enshrined in the second schedule of the RBI Act, 1934. These banks have a paid-up capital and reserves of an aggregate value of not less than Rs. 5 lakhs, they have to satisfy the RBI that their affairs are carried out in the interest of their depositors.

All commercial banks (Indian and foreign), regional rural banks, and state cooperative banks are scheduled banks. Non- scheduled banks are those which are not included in the second schedule of the RBI Act, 1934. At present these are only three such banks in the country.

- **How Banks Function**

Banks make money by lending your money out at interest and by charging you for services provided. Banks keep on lending money.

The other big revenue items generated by banks are the fees they charge. Bank charge for every service, whether it is for an electronic transaction, or permitting a transfer through the Internet banking system.

The banking industry in India is highly regulated. Few important regulations are mentioned below:-

Regulatory Requirements
A bank has to set aside a certain percentage of total funds to meet regulatory requirements. The primary regulatory ratios are **Cash Reserve Ratio (CRR)** and **Statutory Liquidity Ratio (SLR).** RBI uses both these instruments to regulate money supply in the economy. **CRR** is the percentage of net total of deposits a bank is required to maintain in form of cash with RBI. Currently this ratio is at 5.5%. This is used to control the liquidity in the economy. Higher the CRR, the lower is the amount that banks will be able to use for lending activities and vice versa. **SLR** is the minimum percentage of deposits that the bank has to maintain in form of gold, cash and/or other approved securities. Currently, the SLR is 24%. This is used to regulate the credit growth

The core operating income of a bank is interest income (comprises 75-85% in the total income of almost all Indian Banks). Besides interest income, a bank also generates fee-based income in the form of commissions and exchange, income from treasury operations and other income from other banking activities. As banks were assigned a special role in the

economic development of the country, RBI has stipulated that a portion of bank lending should be for the development of under-banked and under-privileged sections, which is called the priority sector. Current rules stipulate that domestic banks should lend 40% and the foreign banks should lend 32% of their net credit to the priority sector. On the cost sides, the major items for a bank are interest paid on different types of deposits, bonds issued and borrowings, and provisioning cost for Non-performing Assets (NPAs)

COMMERCIAL BANK

- **MEANING OF COMMERCIAL BANKS:**

A commercial bank is a financial institution which performs the functions of accepting deposits from the general public and giving loans for investment with the aim of earning profit.

In fact, commercial banks, as their name suggests, axe profit-seeking institutions, i.e., they do banking business to earn profit

They generally finance trade and commerce with short-term loans. They charge high rate of interest from the borrowers but pay much less rate of Interest to their depositors with the result that the difference between the two rates of interest becomes the main source of profit of the banks. Most of the Indian joint stock Banks are Commercial Banks such as Punjab National Bank, Allahabad Bank, Canara Bank, Andhra Bank, Bank of Baroda, etc.

- **FEATURES OF COMMERCIAL BANKS**

The two most distinctive features of a commercial bank are borrowing and lending, i.e., acceptance of deposits and lending of money to projects to earn Interest (profit). In short, banks borrow to lend. The rate of interest offered by the banks to depositors is called the borrowing rate while the rate at which banks lend out is called lending rate.

The difference between the rates is called 'spread' which is appropriated by the banks. Mind, all financial institutions are not commercial banks because only those which perform dual functions of (i) accepting deposits and (ii) giving loans are termed as commercial banks. For example post offices are not bank because they do not give loans.

➢ FUNCTIONS OF COMMERCIAL BANKS

Classified in to two main categories—(A) Primary functions and (B) Secondary functions.

(A) Primary Functions:

1. It accepts deposits:

A commercial bank accepts deposits in the form of current, savings and fixed deposits. It collects the surplus balances of the Individuals, firms and finances the temporary needs of commercial transactions. The first task is, therefore, the collection of the savings of the public. The bank does this by accepting deposits from its customers. Deposits are the lifeline of banks.

- **Deposits are of three types as under:**

(i) Current account deposits:

Such deposits are payable on demand and are, therefore, called demand deposits. These can be withdrawn by the depositors any number of times depending upon the balance in the account. The bank does not pay any Interest on these deposits but provides cheque facilities. These accounts are generally maintained by businessmen and Industrialists who receive and make business payments of large amounts through cheques.

(ii) Fixed deposits (Time deposits):

Fixed deposits have a fixed period of maturity and are referred to as time deposits. These are deposits for a fixed term, i.e., period of time ranging from a few days to a few years. These are neither payable on demand nor they enjoy cheque facilities.

They can be withdrawn only after the maturity of the specified fixed period. They carry higher rate of interest. They are not treated as a part of money supply Recurring deposit in which a regular deposit of an agreed sum is made is also a variant of fixed deposits.

(iii) Savings account deposits:

These are deposits whose main objective is to save. Savings account is most suitable for individual households. They combine the features of both current account and fixed deposits.

They are payable on demand and also withdraw able by cheque. But bank gives this facility with some restrictions, e.g., a bank may allow four or five cheques in a month. Interest paid on savings account deposits in lesser than that of fixed deposit.

- **Difference between demand deposits and time (term) deposits:**

Two traditional forms of deposits are demand deposit and term (or time) deposit:

(i) Deposits which can be withdrawn on demand by depositors are called demand deposits, e.g., current account deposits are called demand deposits because they are payable on demand but saving account deposits do not qualify because of certain conditions on withdrawal. No interest is paid on them. Term deposits, also called time deposits, are deposits which are payable only after the expiry of the specified period.

(ii) Demand deposits do not carry interest whereas time deposits carry a fixed rate of interest.

(iii) Demand deposits are highly liquid whereas time deposits are less liquid,

(iv) Demand deposits are chequable deposits whereas time deposits are not.

2. It gives loans and advances:

The second major function of a commercial bank is to give loans and advances particularly to businessmen and entrepreneurs and thereby earn interest. This is, in fact, the main source of income of the bank. A bank keeps a certain portion of the deposits with itself as reserve and gives (lends) the balance to the borrowers as loans and advances in the form of cash credit, demand loans, short-run loans, overdraft as explained under.

(i) Cash Credit:

An eligible borrower is first sanctioned a credit limit and within that limit he is allowed to withdraw a certain amount on a given security. The withdrawing power depends upon the borrower's current assets, the stock statement of which is submitted by him to the bank as the basis of security. Interest is charged by the bank on the drawn or utilised portion of credit (loan).

(ii) Demand Loans:

A loan which can be recalled on demand is called demand loan. There is no stated maturity. The entire loan amount is paid in lump sum by crediting it to the loan account of the borrower. Those like security brokers whose credit needs fluctuate generally, take such loans on personal security and financial assets.

(iii) Short-term Loans:

Short-term loans are given against some security as personal loans to finance working capital or as priority sector advances. The entire amount is repaid either in one instalment or in a number of installments over the period of loan.

3. Investment:

Commercial banks invest their surplus fund in 3 types of securities:

(i) Government securities, (ii) Other approved securities and (iii) Other securities. Banks earn interest on these securities.

(B) Secondary Functions:

Apart from the above-mentioned two primary (major) functions, commercial banks perform the following secondary functions also.

1. Discounting bills of exchange or bundles:

A bill of exchange represents a promise to pay a fixed amount of money at a specific point of time in future. It can also be encashed earlier through discounting process of a commercial bank. Alternatively, a bill of exchange is a document acknowledging an amount of money owed in consideration of goods received. It is a paper asset signed by the debtor and the creditor for a fixed amount payable on a fixed date. It works like this.

Suppose, A buys goods from B, he may not pay B immediately but instead give B a bill of exchange stating the amount of money owed and the time when A will settle the debt. Suppose, B wants the money immediately, he will present the bill of exchange (Hundi) to the bank for discounting. The bank will deduct the commission and pay to B the present value of the bill. When the bill matures after specified period, the bank will get payment from A.

2. Overdraft facility:

An overdraft is an advance given by allowing a customer keeping current account to overdraw his current account up to an agreed limit. It is a facility to a depositor for overdrawing the amount than the balance amount in his account.

In other words, depositors of current account make arrangement with the banks that in case a cheque has been drawn by them which are not covered by the deposit, then the bank should grant overdraft and honour the cheque. The security for overdraft is generally financial assets like shares, debentures, life insurance policies of the account holder, etc.

- **Difference between Overdraft facility and Loan:**

(i) Overdraft is made without security in current account but loans are given against security.

(ii) In the case of loan, the borrower has to pay interest on full amount sanctioned but in the case of overdraft, the borrower is given the facility of borrowing only as much as he requires.

(iii) Whereas the borrower of loan pays Interest on amount outstanding against him but customer of overdraft pays interest on the daily balance.

3. Agency functions of the bank:

The bank acts as an agent of its customers and gets commission for performing agency functions as under:

(i) Transfer of funds:

It provides facility for cheap and easy remittance of funds from place-to-place through demand drafts, mail transfers, telegraphic transfers, etc.

(ii) Collection of funds:

It collects funds through cheques, bills, bundles and demand drafts on behalf of its customers.

(iii) Payments of various items:

It makes payment of taxes. Insurance premium, bills, etc. as per the directions of its customers.

(iv) Purchase and sale of shares and securities:

It buys sells and keeps in safe custody securities and shares on behalf of its customers.

(v) Collection of dividends, interest on shares and debentures is made on behalf of its customers.

(iv) Acts as Trustee and Executor of property of its customers on advice of its customers.

(vii) Letters of References:

It gives information about economic position of its customers to traders and provides similar information about other traders to its customers.

4. Performing general utility services:

The banks provide many general utility services, some of which are as under:

(i) Traveler's cheques .The banks issue traveler's cheques and gift cheques.

(ii) Locker facility. The customers can keep their ornaments and important documents in lockers for safe custody.

(iii) Underwriting securities issued by government, public or private bodies.

(iv) Purchase and sale of foreign exchange (currency)

- **COMMERCIAL BANKS IN INDIA: ROLE, STRUCTURES AND IMPORTANCE!**

1. **ROLE AND IMPORTANCE OF COMMERCIAL BANKS:**

The functions of commercial banks explain their importance in the economic development of a country.

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:

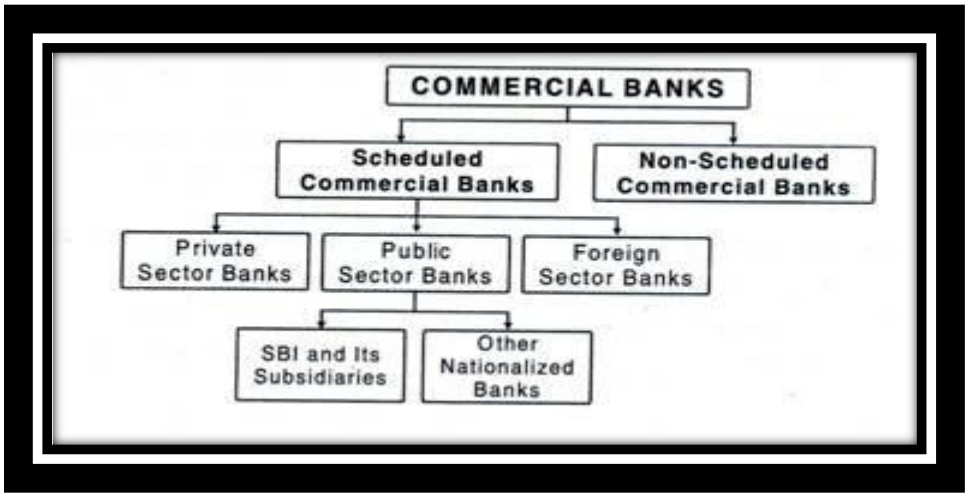
Commercial banks provide credit facilities to rural people by opening branches in the backward areas. The funds collected in developed regions may be channelised for investments in the under developed regions of the country. In this way, they bring about more balanced regional development.

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.

2.STRUCTURE OF COMMERCIAL BANKS IN INDIA:

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.

(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.

COOPERATIVE BANK

- **MEANING OF COOPERATIVE BANK*:***

Cooperative bank is an institution established on the cooperative basis and dealing in ordinary banking business. Like other banks, the cooperative banks are founded by collecting funds through shares, accept deposits and grant loans.

(i) Cooperative banks issue shares of unlimited liability

(ii) In a cooperative bank, one shareholder has one vote whatever the number of shares he may hold.

(iii) Cooperative banks are generally concerned with the rural credit and provide financial assistance for agricultural and rural activities.

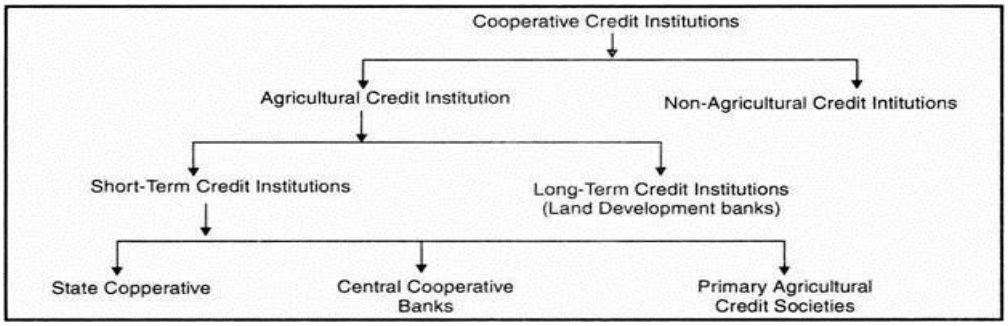
- **STRUCTURE OF COOPERATIVE BANKING*:***

There are different types of cooperative credit institutions working in India. These institutions can be classified into two broad categories- agricultural and non-agricultural. Agricultural credit institutions dominate the entire cooperative credit structure.

Agricultural credit institutions are further divided into short-term agricultural credit institutions and long-term agricultural credit institutions.

The short-term agricultural credit institutions which cater to the short-term financial needs of agriculturists have three-tier federal structure- (a) at the apex, there is the state cooperative bank in each state; (b) at the district level, there are central cooperative banks; (c) at the village level, there are primary agricultural credit societies.

Long-term agricultural credit is provided by the land development banks. The whole structure of cooperative credit institutions is shown in the chart given.



A. Short-Term Rural Cooperative Credit Structure:

In rural India, there exists a 3-tier short-term rural cooperative structure. Tier-I includes state cooperative banks (SCBs) at the state level; Tier-II includes central cooperative banks (CCBs) at the district level; and Tier- III includes primary agricultural credit societies (PACSs).

In 19 states, there exists a 3-tier short-term cooperative credit structure, comprising SCBs, CCBs and PACSs. And in 12 states, there exists a 2-tier short-term cooperative structure. In the north-eastern states, including Sikkim, the structure is 2-tier, comprising only SCBs and PACSs.

1. State Cooperative Banks (SCBs):

State cooperative banks are the apex institutions in the three-tier cooperative credit structure, operating at the state level. Every state has a state cooperative bank.

State cooperative banks occupy a unique position in the cooperative credit structure because of their three important functions:

(a) They provide a link through which the Reserve Bank of India provides credit to the cooperatives and thus participates in the rural finance,

(b) They function as balancing centers for the central cooperative banks by making available the surplus funds of some central cooperative banks. The central cooperative banks are not permitted to borrow or lend among themselves,

(c) They finance, control and supervise the central cooperative banks, and, through them, the primary credit societies.

- **Loans and Advances:**

State cooperative banks are mainly interested in providing loans and advances to the cooperative societies. More than 98 per cent loans are granted to these societies of which about 75 per cent are for the short-period. Mostly the loans are given for agricultural purposes.

2. CENTRAL COOPERATIVE BANKS (CCBS):

Central cooperative banks are in the middle of the three-tier cooperative credit structure.

Central cooperative banks are of two types:

(a) There can be cooperative banking unions whose membership is open only to cooperative societies. Such cooperative banking unions exist in Haryana, Punjab, Rajasthan, Orissa and Kerala.

(b) There can be mixed central cooperative banks whose membership is open to both individuals and cooperative societies. The central cooperative banks in the remaining states are of this type. The main function of the central cooperative banks is to provide loans to the primary cooperative societies. However, some loans are also given to individuals and others.

Capital:

The central cooperative banks raise their working capital from own funds, deposits, borrowings and other sources. In the own funds, the major portion consists of share capital contributed by cooperative societies and the state government, and the rest is made up of reserves.

Deposits largely come from individuals and cooperative societies. Some deposits are received from local bodies and others. Deposit mobilisation by the central cooperative banks varies from state to state.

For example, it is much higher in Gujarat, Punjab, Maharashtra, and Himachal Pradesh, but very low in Assam, Bihar, West Bengal and Orissa. Borrowings are mostly from the Reserve Bank and apex banks.

Loans and Advances:

The number of central cooperative banks in 1991-92 was 361 and the total amount of loans advanced by them in 1991-92 stood at Rs. 14226 crore. About 98 per cent loans are received by the cooperative societies and about 75 per cent loans are short-term. Mostly the loans are given for agricultural purpose.

3. Primary Agricultural Credit Societies (PACSs):

Primary agricultural credit society forms the base in the three-tier cooperative credit structure. It is a village-level institution which directly deals with the rural people. It encourages savings among the agriculturists, accepts deposits from them, gives loans to the needy borrowers and collects repayments.

It serves as the last link between the ultimate borrowers, i.e., the rural people, on the one hand, and the higher agencies, i.e., Central cooperative bank, state cooperative bank, and the Reserve Bank of India, on the other hand.

A primary agricultural credit society may be started with 10 or more persons of a village. The membership fee is nominal so that even the poorest agriculturist can become a member. The members of the society have unlimited liability which means that each member undertakes full responsibility of the entire loss of the society in case of its failure. The management of the society is under the control of an elected body.

Capital:

The working capital of the primary credit societies comes from their own funds, deposits, borrowings and other sources. Own funds comprise of share capital, membership fee and reserve funds. Deposits are received from both members and non- members. Borrowings are mainly from central cooperative banks.

In fact, the borrowings form the chief source of working capital of the societies. Normally, people do not deposit their savings with the cooperative societies because of poverty, low saving habits, and non-availability of better assets to the savers in term of rate of return and riskiness from these societies.

- **<u>Advantages of cooperative credit institutions are given below</u>:**

I. Alternative Credit Source:

The main objective of cooperative credit movement is to provide an effective alternative to the traditional defective credit system of the village money lender. The cooperative banks tend to protect the rural population from the clutches of money lenders. The money lenders have so far dominated the rural areas and have been exploiting the poor people by charging very high rates of interest and manipulating accounts.

II. Cheap Rural Credit:

Cooperative credit system has cheapened the rural credit both directly as well as indirectly:

(a) Directly, because the cooperative societies charge comparatively low interest rates, and

(b) Indirectly, because the presence of cooperative societies as an alternative agency has broken money lender's monopoly, thereby enforcing him to reduce the rate of interest.

III. Productive Borrowing:

An important benefit of cooperative credit system is to bring a change in the nature of loans. Previously the cultivators used to borrow for consumption and other unproductive purposes. But, now, they mostly borrow for productive purposes. Cooperative societies discourage unproductive borrowing.

IV. Encouragement to Saving and Investment:

Cooperative credit movement has encouraged saving and investment by developing the habits of thrift among the agriculturists. Instead of hoarding money the rural people tend to deposit their savings in the cooperative or other banking institutions.

V. Improvement in Farming Methods:

Cooperative societies have also greatly helped in the introduction of better agricultural methods. Cooperative credit is available for purchasing improved seeds, chemical fertilizers, modern implements, etc. The marketing and processing societies have helped the members to purchase their inputs cheaply and sell their produce at good prices.

VI. Role of Cooperative Banks before 1969:

Till the nationalisation of major commercial banks in 1969, cooperative societies were practically the only institutional sources of rural credit. Commercial banks and other financial institutions hardly provided any credit for agricultural and other rural activities. Cooperative credit tothe agriculturists as a percentage of total agricultural credit increased from 3.1 per cent in 1951-52 to 15.5 per cent in 1961-62 and further to 22.7 per cent in 1970-71.

On the other hand, the agricultural credit provided by the commercial banks as a percentage of total agricultural credit remained almost negligible and fell from 0.9 percent in 1951-52 to 0.6 percent in 1961-62 and then rose to 4 per cent in 1970-71.

VII. Role of Cooperative Banks after 1969:

After the nationalisation of commercial banks in 1969, the government has adopted a multi-agency approach. Under this approach, both cooperative banks and commercial banks (including regional rural banks) are being developed to finance the rural sector.

But, this new approach also recognised the prime role to be played by the cooperative credit institutions in financing rural areas because of the following reasons:

(a) Co-operative credit societies are best suited to the socio-economic conditions of the Indian villages.

(b) A vast network of the cooperative credit societies has been built over the years throughout the length and breadth of the country. This network can neither be duplicated nor be surpassed easily.

(c) The cooperative institutions have developed intimate knowledge of the local conditions and problems of rural areas.

VIII. Suitable Federal Structure of Cooperative Banking System:

Cooperative banking system has a federal structure with-

(a) Primary agricultural credit societies at the village level,

(b) Higher financing agencies in the form of central cooperative and state cooperative banks,

(c) land development banks for providing long- term credit for agriculture. Such a banking structure is essential and particularly suited for effectively meeting the financial requirements of the vast rural areas of the country.

Considering the great importance of cooperative banks, particularly in the rural areas, it is not surprising that every committee or commission, that has examined the working of the cooperative banking system in India, has expressed the common view that "cooperation remains the best hope of rural India."

REGIONAL RURAL BANKS

- ***THE OBJECTIVES OF REGIONAL RURAL BANKS:***

In view of the above preamble of the Act the objects and activities of RRBs can be briefed as under:

1) Bridging the credit gaps in rural areas.

2) To develop such measures which could restrict the outflow of rural deposits to urban areas.

3)To reduce regional imbalances and increase rural employment generation activities.

For achieving its objectives the RRBs provide financial assistance to different segments of rural population engaged in rural activities.

- **Area of Functioning of Regional Rural Banks*:***

The Regional Rural Banks are required to function within a limited area for which they are established. Usually the functional area of Each RRB is confined to a few districts of the state in which they are set up. The area of functioning of RRBs is decided by central government in consultation with NABARD and the Sponsor Banks by way of a notification issued in this regard.

It is therefore necessary for RRBs to establish their Head Office in central place of their notified area of functioning because they are also authorized to open their branches or appoint agency within their specified areas.

- **FUNCTIONS OF RRBS ARE AS FOLLOWS**

- RRBs grant loans and advances to small farmers and agricultural laborers so that they can start their own farming activities including purchase of land, seeds and manure.
- RRBs provides banking services at the doorsteps of the rural people ,particularly in those area which are not served by any commercial Bank
- The RRBs charges a lower rate of Interest and thus they reduce the cost of credit in the rural areas.
- RRBs provide loan and other financial assistance to entrepreneurs in villages, sub-urban areas and small towns .So that they become able to enlarge their business.
- Loans to artisans to encourage them for the production of artistic and related goods.
- Encourage the saving habit among the rural and semi-urban population.

- Carrying out government operations like disbursement of wages of MGNREGA workers, distribution of pensions etc.
- Providing Para-Banking facilities like locker facilities, debit and credit cards, mobile banking, internet banking, UPI etc.
- Small financial banks.

List of Regional Rural banks

Presently there are 45 RRBs in India.

Some of them are given below:

1. Andhra Pradesh

- Andhra Pradesh GrameenaVikas Bank
- Andhra PragathiGrameena Bank
- Chaitanya Godavari Grameena Bank
- SaptagiriGrameena Bank

2. Himachal Pradesh

- Himachal Pradesh Gramin Bank

3. Punjab

- Punjab Gramin Bank

4. Rajasthan

- Baroda Rajasthan KshetriyaGramin Bank
- Rajasthan MarudharaGramin Bank

5. Tamil Nadu

- Tamil Nadu Grama Bank

6. Telangana

- TelanganaGrameena Bank

7. Tripura

- Tripura Gramin Bank

8. Uttar Pradesh

- Aryavart Bank
- Prathama UP Gramin Bank
- Baroda UP Gramin Bank
- KashiGomtiSamyutGramin Bank
- PurvanchalGramin bank

TYPES OF BANKS

1. Commercial Banks:-These banks play the most important role in modern economic organization. Their business mainly consists of receiving deposits, giving loans and financing the trade of a country. They provide short-term credit, i.e., lend money for short periods. This is their special feature.

2. Exchange Banks:-Exchange banks finance mostly the foreign trade of a country. Their main function is to discount, accept and collect foreign bills of exchange. They also buy and sell foreign currencies and help businessmen to convert their money into any foreign money they need. Their share in the internal trade of a country is usually small. In addition, they carry on ordinary banking business too.

3. Industrial Banks:-There are a few industrial banks in India. But in some other countries, notably Germany and Japan, these banks perform the function of advancing loans to industrial undertakings. Industries require capital for a long period for buying machinery and equipment. Industrial banks provide this type of Mock capital. Industrial banks have a large capital of their own. They also receive deposits for longer periods. They are thus in a position to advance long-term loans.

In India, the Central Government set up an Industrial Finance Corporation of India (IFC1) in 1948. Its activities have since then been greatly enlarged. Further the States have also set up

State Financial Corporations. The Central Government has also established the Industrial Credit and Investment Corpor-ation of India (ICICI) and the National Industrial Development Corporation for the financing and promotion of industrial enterprises. In 1964 the Industrial Development Bank of India (1DBI) was established as the apex or top term-lending institution. These new institutions fill important gaps in our system of industrial finance.

4. Agricultural or Co-operative Banks:-The main business of agricultural banks is to provide funds to farmers. They are worked on the co-operative principle. Long-term capital is provided by land mortgage banks, nowadays called land-development banks, while short-term loans are given by co-operative societies and co-operative banks. Long-term loans are needed by the farmers for purchasing land or for permanent improvements on land, while short-period loans help them in purchasing implements, fertilizers and seeds. Such banks and societies are doing useful work in India.

5. Savings Banks:-These banks (perform the useful service of collecting small savings. Commercial banks too run "savings departments" to mobilize the savings of men of small means. The idea is to encourage thrift and discourage hoarding. Post Office Saving Banks in India are doing this useful work.

6. Central Banks:-Over and above the various types of banks mentioned above, there exists in almost all countries today a Central Bank. It is usually controlled and quite often owned by the government of the country.

7. Utility of Banks:-An efficient banking system is absolutely necessary for a country, if it is to progress economically. The services that an efficient banking system can render a country are indeed very valuable. Undeveloped banking system is not only an index of economic backwardness of a country; it is also an important cause of it. The banking system can be useful in the following ways, in addition to what has been mentioned in the functions of banks.

FUNCTIONS & ROLE OF BANKS IN ECONOMIC DEVELOPMENT OF A COUNTRY

1. Capital Formation:-Banks play an important role in capital formation, which is essential for the economic development of a country. They mobilize the small savings of the people scattered over a wide area through their network of branches all over the country and make it available for productive purposes.

Now-a-days, banks offer very attractive schemes to attract the people to save their money with them and bring the savings mobilized to the organized money market. If the banks do not perform this function, savings either remains idle or used in creating assets, which are low in scale of plan priorities.

2. Creation of Credit:-Banks create credit for the purpose of providing more funds for development projects. Credit creation leads to increased production, employment, sales and prices and thereby they cause faster economic development.

3. Channelizing the Funds to Productive Investment:-Banks invest the savings mobilized by them for productive purposes. Capital formation is not the only function of commercial banks. Pooled savings should be distributed to various sectors of the economy with a view to increase the productivity of the nation. Then only it can be said to have performed an important role in the economic development of the nation.

Commercial Banks aid the economic development of the nation through the capital formed by them. In India, loan lending operation of commercial banks subject to the control of the RBI. So our banks cannot lend loan, as they like.

4. Fuller Utilization of Resources:-Savings pooled by banks are utilized to a greater extent for development purposes of various regions in the country. It ensures fuller utilization of resources.

5. Encouraging Right Type of Industries:-The banks help in the development of the right type of industries by extending loan to right type of persons. In this way, they help not only for industrialization of the country but also for the economic development of the country. They grant loans and advances to manufacturers whose products are in great demand. The manufacturers in turn increase their products by introducing new methods of production and assist in raising the national income of the country.

6. Bank Rate Policy:-Economists are of the view that by changing the bank rates, changes can be made in the money supply of a country. In our country, the RBI regulates the rate of interest to be paid by banks for the deposits accepted by them and also the rate of interest to be charged by them on the loans granted by them.

7. Bank Monetize Debt:-Commercial banks transform the loan to be repaid after a certain period into cash, which can be immediately used for business activities. Manufacturers and

wholesale traders cannot increase their sales without selling goods on credit basis. But credit sales may lead to locking up of capital. As a result, production may also be reduced. As banks are lending money by discounting bills of exchange, business concerns are able to carry out the economic activities without any interruption.

8. Finance to Government:-Government is acting as the promoter of industries in underdeveloped countries for which finance is needed for it. Banks provide long-term credit to Government by investing their funds in Government securities and short-term finance by purchasing Treasury Bills.

9. Bankers as Employers:-After the nationalization of big banks, banking industry has grown to a great extent. Bank's branches are opened in almost all the villages, which leads to the creation of new employment opportunities. Banks are also improving people for occupying various posts in their office.

10. Banks are Entrepreneurs:-In recent days, banks have assumed the role of developing entrepreneurship particularly in developing countries like India. Developing of entrepreneurship is a complex process. It includes the formation of project ideas, identification of specific projects suitable to local conditions, inducing new entrepreneurs to take up these well-formulated projects and provision of counseling services like technical and managerial guidance.

ADVANTAGES OF BANKING SYSTEM

1. Economies of Large Scale Operations:-Under the branch banking system, the bank with a number of branches possesses huge financial resources and enjoys the benefits of large-scale operations,

(a) Highly trained and experienced staff is appointed which increases the efficiency of management,

(b) Division of labor is introduced in the banking operations which ensures greater economy in the working of the bank. Right persons are appointed at the right place and specialization increases,

(c) Funds are made available liberally and at cheaper rates,

(d) Foreign exchange business is done economically,

(e) Large financial resources and wider geographical coverage increases public confidence in the banking system.

2. Spreading of Risk:-Another advantage of the branch banking system is the lesser risk and greater capacity to meet risks,

(a) Since there is geographical spreading and diversification of risks, the possibility of the failure of the of the bank is remote,

(b) The losses incurred by some branches may be offset by the profits earned by other branches,

(c) Large resources of branch banks increase their ability to face any crisis.

3. Economy in Cash Reserves:-Under the branch banking system, a particular branch can operate without keeping large amounts of idle reserves. In time of the need, resources can be transferred from one branch to another.

4. Diversification on Deposits and Assets:-There is greater diversification of both deposits and assets under branch banking system because of wider geographical coverage,

(a) Deposits are received from the areas where savings are in plenty,

(b) Loans are extended in those areas where funds are scarce and interest rates are high. The choice of securities and investments is larger in this system which increases the. safety and liquidity of funds.

5. Cheap Remittance Facilities:-Since bank branches are spread over the whole country, it is easier and cheaper to transfer funds from one place to another. Inter-branch indebtedness is more easily adjusted than inter-bank indebtedness.

6. Uniform Interest Rates:-Under branch banking system, mobility of capital increases, which in turn, brings about equality in interest rates. Funds are transferred from areas with excessive demand for money to areas with deficit demand for money. As a result, the uniform rate of interest prevails in the whole area; it is prevented from rising in the excessive demand area and from falling in the deficit demand area.

7. Proper Use of Capital:-There is proper use of capital under the branch banking system. If a branch has excess reserves, but no opportunities for investment, it can transfer the resources to other branches which can make most profitable use of these resources.

8. Better Facilities to Customers:-The customers get better and greater facilities under the branch banking system. It is because of the small number of customers per branch and the increased efficiency achieved through large scale operations.

9. Banking Facilities in Backward Areas:-Under the branch banking system, the banking facilities are not restricted to big cities. They can be extended to small towns and rural as well as underdeveloped areas,. Thus, this system helps in the development of backward regions of the country.

10. Effective Control:- Under the branch banking system, The Central bank than have a more efficient control over the banks because it has to deal only with few big banks and nor with each individual branch. This ensures better implementation of monetary policy.

DISADVANTAGES AND LIMITATIONS OF BANKING SYSTEM

1. Problem of Management:-Under the branch banking system a number of difficulties as regards management, supervision and control arise:

(a) since the management of the bank gets concentrated at the head office, the managers can afford to be lax and indulgent in their duties and are often involved in serious irregularities while using the funds.

(b) Since the branch manager has to seek permission from the head office on each and every matter, this results in unnecessary delay and red- tapism in the banking business.

2. Lack of Initiative:- Branch managers generally lack initiative on all-important matters; they cannot take independent decisions and have to wait for. The clearance signal from the head office.

3. Monopolistic Tendencies:-Branch banking encourages monopolistic tendencies in the banking system. A few big banks dominate and control the whole banking system of the country through their branches. This can lead to the concentration of resources into a few hands.

4. Regional Imbalances:-Under branch banking system, the financial resources collected in the smaller and backward regions are transferred to the bigger industrial centres. This encourages regional imbalances in the country.

5. Adverse Linkage Effect:-Under branch banking system, the losses and weaknesses of some branches also have their effect on other branches of the bank.

6. Inefficient Branches:-In this system, the weak and unprofitable branches continue to operate under the protection cover of the large and more profitable branches.

7. Other Defects:-Other defects of branch banking system arc as follows:

(a) Preferential treatment is given to the branches near the head office,

(b) Higher interest rates are charged in the developed area to compensate for the lower rates charged in the backward areas,

(c) There is concentration and unhealthy competition among the branches of different banks in big cities,

(d) Many difficulties are faced when a bank opens branches. In foreign countries.

IMPORTANT QUESTION:-

❖ SHORT QUESTIONS (2 MARKS):-

1) Define Bank?
2) Objectives of banks.
3) Write three functions of banking.
4) Define Commercial bank.
5) Define Co-operative bank.
6) Types of Private Sector Banks.
7) Types of Public Sector Banks.

❖ LONG QUESTIONS (10 MARKS):-

1) Define Banking? Explain its objectives, functions & significance?
2) Define Banking? Explain the structure of Indian Banking & limitations?
3) Discuss the functions and types of commercial banks in detail.
4) Write functions of bank in an economic development?
5) Discuss role of banking in an economic development in detail.

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UNIT-II

RESERVE BANK OF INDIA (RBI)

The Reserve Bank of India was established on April 1, 1935 in accordance with the provisions of the Reserve Bank of India Act, 1934.

The Central Office of the Reserve Bank was initially established in Calcutta but was permanently moved to Mumbai in 1937. The Central Office is where the Governor sits and where policies are formulated.Though originally privately owned, since nationalization in 1949, the Reserve Bank is fully owned by the Government of India.

Reserve Bank of India (RBI) is the central bank of the country. RBI is a statutory body. It is responsible for the printing of currency notes and managing the supply of money in the Indian economy.

Initially, the ownership of almost all the share capital was in the hands of non-government shareholders. So in order to prevent the centralization of the shares in few hands, the RBI was nationalized on January 1, 1949.

➢ STRUCTURE OF RBI

Central Board:-The Reserve Bank's affairs are governed by a central board of directors. The **Central Board of Directors** is the apex body in the governance structure of the Reserve Bank. There are also four **Local Boards** for the Northern, Southern, Eastern and Western areas of the country which take care of local interests. The central government appoints/nominates directors to the Central Board and members to the Local Boards in accordance with the Reserve Bank of India (RBI) Act. The composition of the Central Board is enshrined under Section 8(1) of the RBI Act, 1934.

➢ **The Central Board consists of:**

1) The Governor
2) 4 Deputy Governors of the Reserve Bank
3) 4 Directors nominated by the central government, one from each of the four Local Boards as constituted under Section 9 of the Act
4) 10 Directors nominated by the central government
5) 2 government officials nominated by the central government

➢ **The Central Board is assisted by three committees:**

1) The Committee of the Central Board (**CCB**)
2) The Board for Financial Supervision (**BFS**)
3) The Board for Regulation and Supervision of Payment and Settlement Systems (**BPSS**)

➢ FUNCTIONS OF RBI

1. **Monetary Authority:-**The Reserve Bank of India being the central bank of the country is the monetary authority of India and the sole authority vested with the power to issue currency notes, regulate the supply of currency and credit in the economy to secure monetary and price stability.
2. **Regulate & Supervise Financial Stability and Financial inclusion:-**It is also the responsibility of RBI to regulate & supervise the banking sector with an eye on securing financial stability and financial inclusion.
3. **Currency Management:-** Currency Management is the process of managing the life cycle of the notes, which includes:-

1) Assessing the printing requirement of various denominations of notes,
2) Placing indents with the note printing presses,
3) Supplying and distributing adequate quantity of currency throughout the country

4) Ensuring the quality of banknotes in circulation by continuous supply of clean notes and timely withdrawal of soiled notes.

Section 23 of the RBI Act, 1934, had mandated that the function of issuance of bank notes (above 1 Rupee) is to be conducted by the RBI through a separate department called the Issue Department.

4. **Foreign Exchange Management:-**The Reserve Bank oversees the foreign exchange market in India. It supervises and regulates it through the provisions of the Foreign Exchange Management Act (FEMA), 1999.
5. **Banker to Banks:-**RBI also act as a banker to banks and Governments by maintaining their accounts and carrying out transactions on their behalf as well as providing them banking services.
6. **Banker to Government:-**Managing the Government's banking transactions is one of the key functions of the RBI. Like individuals, businesses and banks, Governments too need a banker to carry out their financial transactions in an efficient way, including the raising of resources from the public. Since its inception, the RBI has undertaken the traditional central banking function of managing the Government's banking transactions. The central bank also serves as an agent and adviser to the Government.
7. **Regulate and Supervise the financial system:-**Financial system in India is carried out by different regulatory authorities. The Reserve Bank regulates and supervises the major part of the financial system. The supervisory role of the Reserve Bank involves commercial banks, Urban Co-operative Banks (UCBs), certain Financial Institutions (FIs) and Non-Banking Financial Companies (NBFCs). Some of the FIs, in turn, regulate and/or supervise other institutions in the financial sector.

In addition to these, Reserve Bank of India also represents India at the International Monetary Fund (IMF), promotes the growth of economy, act as a lender of last resort to commercial banks, strengthen and support small local banks and encourage banks to open branches in rural areas, publish economic data, etc.

MONETARY POLICY

MEANING & DEFINITATION OF MONETARY POLICY

Monetary Policy refers to the credit control measures adopted by the central bank of a country. Monetary policy "as policy employing central bank's control of the supply of money as an instrument for achieving achieves of general economic policy."

Expansionary policy :- It occurs when a monetary authority uses its procedures to stimulate the economy. An expansionary policy maintains short-term interest rates at a lower than usual rate or increases the total supply of money in the economy more rapidly than usual. **It is traditionally used to try to reduce unemployment** during a recession by decreasing interest rates in the hope that less expensive credit will entice businesses into borrowing more money and thereby expanding.

Contractionary monetary :- This policy maintains short-term interest rates greater than usual, slows the rate of growth of the money supply, or even decreases it to slow short-term economic growth and lessen inflation. **Contractionary monetary policy can result in increased unemployment and depressed borrowing** and spending by consumers and businesses, which can eventually result in an economic recession if implemented too vigorously.

OBJECTIVES OF MONETARY POLICY:-

The following are the principal objectives of monetary policy:

1. Full Employment:- Full Employment has been ranked among the foremost objectives of monetary policy. It is an important goal not only because unemployment leads to wastage of potential output, but also because of the loss of social standing and self-respect.

2. Price Stability :- One of the policy objectives of monetary policy is to stabilize the price level. Both economics and favour this policy because fluctuations in price bring uncertainty and instability to the economy.

3. Economic Growth:- One of the most important objectives of monetary policy in in recent years has been the rapid economic growth of an economy. – Economic growth is defined as "the process where by the real per capita income of a country increases over a long period of time."

4. Balance of Payments:- Another objectives of monetary policy since the 1950s has been to maintain equilibrium in the balance of payments.

5. Exchange Rate Stability:-Exchange rate is the price of a home currency expressed in terms of any foreign currency. If the exchange rate is very volatile leading to frequent ups and downs in the exchange rate, the international community might lose confidence in our economy. The monetary policy aims at maintaining the relative stability in the exchange rate.

6. Neutrality of Money:- Economist such as Wicksted, Robertson has always considered money as a passive factor. According to them, money should play only a role of medium of exchange and not more than that. Therefore, the monetary policy should regulate the supply of money.

7. Equal Income Distribution:- Many economists used to justify the role of the fiscal policy is maintaining economic equality. However in recent years economists have given the opinion that the monetary policy can help and play a supplementary role in attaining an economic equality.

#TYPES OF MONETARY POLICY:-

Monetary policy design changes as per the goals set for the monetary policy and the emerging economic scenario. The monetary policy is characterized as expansionary policy, Contractionary policy, counter cyclical policy, rule based policy or discretionary policy.

1. Expansionary Monetary Policy:- Expansionary or easy monetary policy aims at encouraging spending on goods and services by expanding the supply of credit and money by lowering the policy rates (bank rate or repo rate), lowering the reserve requirements and purchasing the government securities from the market.

2. Contractionary Monetary Policy:-Contractionary or tight monetary policy aims at preventing inflation by contracting the money supply.

Contraction in money supply is achieved by increasing the policy rates, increasing the reserve requirements and purchasing the government securities from the market.

3. Countercyclical Monetary Policy:-Countercyclical policy aims at moderating the cyclical fluctuations in the economy and stabilizing the economy around its trend path by following countercyclical measures.

4. Rule Based Monetary Policy:- Under rule based policy money supply and related variables are controlled by predetermined rules, norms and standards.

The central bank authorities cannot use their discretion to change the values of these variables.

5. Discretionary Monetary Policy:- Discretionary Monetary Policy allows the central bank greater autonomy in the conduct of monetary policy. Under such a policy rather than getting constrained by the pre-set rule, the central banks, after assessing the emerging economic scenario and using its own judgment, can change the values of money supply and the related variables.

INSTRUMENTS OF MONETARY POLICY OR TECHNIQUES OF CREDIT CONTROL

Credit control is an important tool used by Reserve Bank of India, a major weapon of the monetary policy used to control the demand and supply of money in the economy.

I. Quantitative Instruments:-

1. Bank Rate:- The bank rate, also known as the Discount Rate, is the oldest instrument of monetary policy. Bank rate is the rate at which the RBI discounts – or, more accurely.

2. Open market Operations:- open market operations are the means of implementing monetary policy by which a central bank controls its national money supply by buying and selling government securities or other financial instrument.

3. Variations in the Reserve Requirement:- The reserve bank also uses the method of variable reserve requirements to control credit in India. By changing the ratio, The reserve bank seeks to influence the credit creation power of the commercial banks.

4. Repo Rate and Reserve Repo Rate:-whenever the banks have any shortage of funds they can borrow it from RBI. Repo rate is the rate at which banks borrow rupees from RBI. Current repo rate is **4.40%** as on **27 March 2020.**

5. Liquidity Adjustments Facility:- It is a cool, used in monetary policy that allows banks to borrow money through repurchase agreements. This arrangement allows banks to respond to liquidity pressures and is used by governments to assure basic stability in the financial markets.

II. Qualitative Instruments:-

1. Rationing of credit:- Credit rationing is a method of controlling and regulating the purpose for which credit is granted by commercial bank. It aims to limit the total amount of loans and advances granted by commercial banks.

2. Margin Requirements:- Margin is the difference b/w the market value of a security and its maximum loan value. Marginal requirement of loan can be increased or decreased to control the flow of chart.

3. Publicity:- RBI uses media for the publicity of its views on the current market condition and its directions that will be required to be implemented by the commercial banks to control the unrest. Regulation of Consumer Credit: If there is excess demand for certain consumer durable leading to their high prices, central bank can reduce consumer credit by increasing down payment, and reducing the number of installments of repayment of such credit.

4. Moral Suasion:-Moral Suasion means persuasion and request. To arrest inflationary situation central bank persuades and request the commercial banks to refrain from giving loans for speculative and non-essential purposes.

5. Direct Action:- Under the banking Regulation Act, the Central Bank has the authority to take strict action against any of the commercial bank that refuses to obey the directions given by Reserve Bank of India.

SIGNIFICANCE OF MONETARY POLICY:-

1. Control Inflation or Deflation: Monetary policy is the policy used by the government of a country to control inflation or deflation in an economy and this policy been implemented by the central bank through the ministry of finance.

2. Availability of the Supply of money and Credit:- Monetary policy is concerned with the charges in the supply of the money and credit. It refers to the policy measures under taken by the government or central bank to influence the availability, cost and use of money and credit with the help of monetary techniques to achieve specific objectives.

3. Integrated Interest Rate Structure:- In an underdeveloped economy, there is absence of an integrated interest rate structure. There is wide disparity of interest rates prevailing in the different sectors of the economy and these rates do not respond to the changes in the bank rate, thus making the monetary policy ineffective.

4. Effective Central Banking:- To meet the developmental needs the central bank of an underdeveloped country must function effectively to control and regulate the volume of credit through various monetary instruments, like bank rate, open market operations, cash-reserve ratio etc.

5. Long-Term Loans for Industrial Development:- Monetary policy can promote industrial development in the underdevelopment countries by promoting facilities of medium-term and long-term loan to the manufacturing units.

6. Creation of Financial Institutions:- The Monetary policy in a developing economy must aim to improve its currency and credit system. More banks and financial institutions should be set up, particularly in both areas which lack these facilities.

LIMITATIONS OF MONETARY POLICY:-

1. Large Non-monetized Sector:- There is a large non-monetized sector which hinders the success of monetary policy in such countries. People mostly live in rural areas where barter is practiced. Consequently, monetary policy fails to influence this large segment of the economy.

2. Undeveloped Money and Capital Markets:- The money and capital markets are undeveloped. These markets lack in bills, stocks and shares which limit the success of monetary policy.

3. Large Number of NBFLs:- Non-bank financial intermediaries like the indigenous bankers operate on a large scale in such countries but they are not under the control of the monetary authority. The factor limits the effectiveness of monetary policy in such countries.

4. High Liquidity:- The majority of commercial banks possess high liquidity so that they are not influenced by the credit policy of the central bank. This also makes monetary policy less effective.

5. Foreign Banks:- In almost every underdeveloped country foreign owned commercial banks exist. They also render monetary policy less effective by selling foreign assets and drawing money from their head officers when the central bank of the country is following a tight monetary policy.

6. Small Bank Money:- Monetary policy is also not successful in such countries because bank money comprises a small proportion of the total money supply in the country. As a result, the central bank is not in a position to control credit effectively.

7. Money not deposited with Banks:- The well-to-do people do not deposit money with banks but use it in buying jewellery, gold, real estate, in speculation, in conspicuous consumption, etc. Such activities encourage inflationary pressures because they lie outside the control of the monetary authority.

BANKING SECTOR REFORMS IN INDIA

- **BEFORE INDEPENDENCE**

Modern banking in India started way back to 1786, with the establishment of the General Bank of India. In 1806, the East India Company established the first Presidency Bank in Kolkata.
Two more banks were established in 1840 and 1843 named Bank of Bombay and Bank of Madras.
Reserve Bank of India (RBI) came into formation on April 1, 1935, with the enactment 50 of the Reserve Bank of India Act, 1934.

- **FIRST PHASE OF REFORMS – THE NARASIMHAM COMMITTEE I (1991)**

To rebuild the financial health of commercial banks and to make their functioning efficient and profitable, the Government of India appointed a High-Level Committee. The name of the committee was "The Committee on Financial System" (CFS) under the Chairmanship of M. Narasimham**. (Maidavolu Narasimham was the thirteenth governor of the Reserve Bank of India from 2 May 1977 to 30 November 1977.)**

The purpose of the Narasimham-I Committee was to study all aspects relating to the structure, organization, functions and procedures of the financial systems and to recommend improvements in their efficiency and productivity

It was a committee of **nine members along with Mr. M, Narasimham.**

The committee gave its recommendation in Nov 1991 which was the blueprint of the first-generation banking sector reforms in India. The objectives of the committee were given below

- To make recommendations for **improving and modernizing the organizational systems and procedures as well as managerial policies**
- Make recommendations for **infusing greater competitive** viability into the system so as to enable the banks and financial institution to respond more effectively to the emerging credit needs of the economy
- To examine the cost, composition and adequacy of the capital structure of the various financial institutions and to make suitable recommendations in this regard
- **To review the relative roles of different types of financial institutions in the financial system** and to make recommendations for their balanced growth.

Many of the recommendations of the committee have been accepted and implemented by the Government of India.

1. Improvement in Financial Health: The first necessary step **was to improve the financial health of banks**. These measures aimed at reducing the vulnerability (weak condition) of banks in the face of fluctuations in the economic environment. These included the introduction of prudential norms more or less in keeping with international thinking.

2. Lowering SLR and CRR:- The high SLR and CRR reduced the profits of the banks. The SLR had been reduced from 38.5% in 1991 to 25% in 1997. This has left more funds with banks for allocation to agriculture, industry, trade etc.

The Cash Reserve Ratio (CRR) is the cash ratio of banks total deposits to be maintained with RBI. The CRR had been brought down from 15% in 1991 to 4.1% in June 2003. The purpose is to release the funds locked up with RBI

2. Transparency on Financial Statement: The Committee was of the view that the balance sheets of banks and financial institutions should be made transparent and full disclosures are made in the balance sheets as required by the International Accounting Standards Committee. In conformity with this recommendation, RBI modified the format of balance sheets of banks in 1992.

3. Institutional Strengthening: Institutional framework conducive to the development of banks needs to be developed so, an important aspect of banking sector reform was to strengthen the institutional base of the banking system. **These included a variety of measures such as the licensing of new banks in private sector**, enabling the public sector banks to go to the market and augment their capital base**, creation of Debt Recovery Tribunals to deal with loans** owed to the commercial banks.

4. Freedom of Operation:- Scheduled Commercial Banks are given freedom **to open new branches and upgrade extension counters, after attaining capital adequacy ratio** (The capital adequacy ratio (CAR) is a measurement of a bank's available capital expressed as a percentage of a bank's risk-weighted credit exposures. The capital adequacy ratio, also known as capital-to-risk weighted assets ratio (CRAR), is used to protect depositors and promote the stability and efficiency of financial systems around the world) and prudential accounting norms.

The banks are also permitted to close non-viable branches other than in rural areas.

5. Asset Reconstruction Fund: An Asset Reconstruction Company is a specialized financial institution that buys the NPAs or bad assets from banks and financial institutions so that the latter can clean up their balance sheets. Or in other words, ARCs are in the business of buying bad loans from banks. This helps banks to concentrate in normal banking activities.

The Committee suggested the setting up of an ARF to take over bad and doubtful assets of the balance sheets of the banks and DFIs at a discount so that the banks could recycle the funds realized through this process into new productive assets. The rate of discount will be determined by independent auditors on the basis of clearly stipulated guide lines.

6. Supervision of Commercial Banks:- The RBI has set up a Board of financial Supervision with an advisory Council to strengthen the supervision of banks and financial institutions. In 1993, RBI established a new department known as Department of Supervision as an independent unit for supervision of commercial banks.

- **SECOND PHASE OF REFORMS – NARASIMHAM COMMITTEE-II**

The recommendations of Narasimham Committee-I (1991) provided the blueprint for first generation reforms of the financial sector. The period 1992-97 witnessed laying of the foundations for reforms of the banking sector in India.

In 1998, the Government set up Committee on Banking Sector Reforms in India under the chairmanship of M. Narasimham **in order to review the progress of banking sector reforms to date and chart a programme of financial sector reforms necessary to strengthen the Indian Financial System and make it internationally competitive.**

- **THE BENEFITS OF THE SECOND PHASE OF BANKING SECTOR REFORMS INDIA BY NARASIMHAM COMMITTEE RECOMMENDATIONS ARE AS FOLLOWS.**

1. Deregulation of Branch Licensing: With the Narasimham Committee's recommendations governing branch licensing restrictions, the RBI changed its licensing policy in 1992 in order to give banks the operational autonomy to rationalize their branch networks.

The Committee recommended that branch licensing be abolished and the matter of opening branches or closing of branches (other than branches for the present) be left to the

commercial judgments of the individual banks. **Banks were allowed to shift their existing branches within the same locality, open certain types of specialized branches**, convert existing nonviable rural branches into satellite offices, a spin-off the business of a branch, and open extension counters and administrative units without prior approval of the RBI.

2. Prudential Norms and Disclosure Requirements: With regard to income recognition, the Committee recommended the introduction of the norm of 90 days i.e. income stops accruing when interest on or installment of principal is not paid within 90 days, in a phased manner by the year 2002, which was 180 days previously. It also suggested for a general provision on standard assets which was not there previously. As far as the future loans were concerned, prudential norms as income recognition asset classification and provisioning norms should be applied to government guaranteed advances in the same manner as for any other advances. The Banking Sector Reforms in India helped to transform the Indian economy.

3. Capital Adequacy: **The statutory minimum reserves of capital which a bank or other financial institution must have available**. Capital Adequacy ratio is the ratio of minimum capital to risk asset ratio. In April 1992 RBI fixed CAN at 8%. Taking the present financial scenario of the economy into account, the Committee recommended that **market risk which is defined as the risk of losses** with respect to on and off-balance sheet positions **arising from movements in market prices should be given greater attention.**

The report suggested that RBI should work towards implementing the amendment to the Basel norms which is the standard measurement method which uses a building block approach in which specific risk and 86 general market risk arising from debt and equity positions are calculated separately

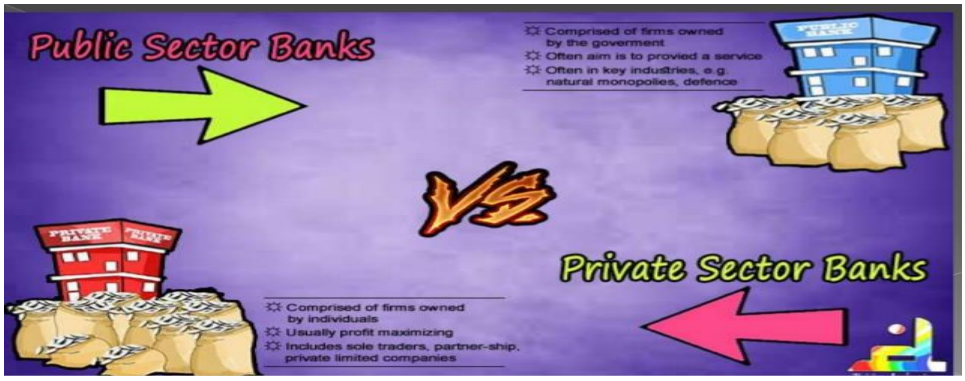
4. Non-Performing Assets (NPAs):- One serious problem faced by the public sector banks in the 1990s was a high proportion of NPAs. An NPA is an asset from which **income is overdue for more than six months**. According to the second Narasimhan Committee report

(1998), **"No other single indicator reflects the quality of assets and their impact on banks' viability than the NPA figures in relation to advances."**

VERMA PANEL REPORT

➢ BACKGROUND

In 1990s, a tremendous progress was seen in the banking sector of India banking sector was dominated by public sector banks due to liberalization in India, several new private sector banks emerged customer friendly Due to which, some public sector banks turned negative while some public sector banks maintained their dominance



➢ PURPOSE:-

There was need to study the performance of all public sector banks to give helping hand to poor or loss-making public sector banks in India.

For this purpose, a working or committee was appointed by the RBI in consultation with Government of India to identify and examine the problems of weak banks and also to give suggestion for their restructuring, known as Verma committee or working group on restructuring weak public sector banks

➢ CONSTITUTION

'The working group was set up in February 1999 under the chairmanship of shri M.S. Verma, former chairman of State Bank of India and Honorary Adviser to the Reserve Bank of India

The main purpose of its constitution was to help the public sector banks to transform them into profit making.

➢ DUTIES

1) Formulate criteria for identification of weak public sector banks
2) To study and examine the problems of weak banks
3) To undertake a case by case examination of the weak banks and to identify those which are potentially revival
4) To suggest a strategic plan of financial, organizational and operational restructuring of weak public sector banks.

➢ REPORT SUBMISSION

1) In October 1999, the working group on restructuring weak public sector banks submitted its report to the Reserve Bank of India
2) Which is third in the banking sector reform trilogy
3) The report identified eight banks in which the accumulated losses and net NPAs exceeded the net worth of the bank which were Allahabad bank, Indian bank, Indian Overseas bank, Punjab and Sind bank, State bank of Indore, Mysore and Travancore and United bank of India
4) It has identified three banks where operating profits less the income on recapitalization bonds has been negative for three years ending 1998-99 which were Indian bank, UCO bank and United bank of India.
5) The group identified seven parameters for identification of bank‟s strength or weakness covering the aspects of solvency, earning capacity and profitability. These parameters are capital adequacy (8-12%), coverage ratio (0.5%), return on assets (median level), net interest margin (median level), ratio of operating profit to average working funds and cost to income (median level) and ratio of staff cost to income (median level).
6) The group identified continuous decline in profitability and efficiency of Indian bank, UCO bank and United bank of India and their dependence on capital support from government are causes for concern.
7) It also identified the reason behind this weakness which was related with operations, management and human resources and there was need for immediate restructuring of these three banks

RECOMMENDATION OF VERMA COMMITTEE
OR
WORKING GROUP ON RESTRUCTURING OF WEAK PUBLIC SECTOR BANKS

1) Seven parameters covering solvency, earning capacity and profitability have been identified

2) The tests/definitions provided by the Committee On Banking Sector Reforms (CBSR) should be supplemented by performance analysis based on the seven parameters for identifying weakness in banks in future

3) The seven parameters can also be used to evolve benchmarks for competitive level of performance by the public sector banks

4) Narrow banking can't by itself be adopted as a long-term restructuring strategy

5) Closure involves many negative externalities affecting depositors, borrowers and employees, and should not be exercised unless all other options are exhausted

6) The government, management and employee unions must agree upon every important condition of the proposed restructuring programme before it is begun.

7) Restructuring of weak banks should be a two-stage operation. Stage one involves operational, organizational and financial restructuring aimed at restoring competitive efficiency and Stage two covers options of privatization or merger.

8) A 30-35 percent reduction in staff cost required in the three identified weak banks to enable them to reach the median level of ratio of staff cost to operating income.

9) The organizational restructuring includes delaying of the decision making process relating to credit, rationalization of branch network etc.

10) Financial restructuring involves efforts to maintain a CAR well above the minimum required level, further recapitalization subject conditionalities relating to operational and organizational restructuring of the recipient bank etc.

➢ CONCLUSION

In short, the committee considers that the banking sector should be restructured to bring efficiency to it. Various issues have been raised by the Verma committee regarding the exact method of restructuring. But this requires detailed attention separately.

BASEL COMMITTEE

Basel Committee - 1974:- The central bank governors of the G10 countries established a Committee on Banking Regulations and Supervisory Practices.

The group of ten countries consist of Belgium, Canada, France, Germany, Italy, Japan, the Netherlands, Sweden, the United Kingdom and the United States, Switzerland was also included as part of the group.

Later renamed as the Basel Committee on Banking Supervision(BCBS). The Basel Committee on Banking Supervision provides a forum for regular cooperation on banking supervisory matters.

Its mandate is to strengthen the regulation, supervision and practices of banks worldwide with the purpose of enhancing financial stability.

Basel Committee on Banking Supervision (BCBS) came into being under the patronage of Bank for International Settlements (BIS), Basel, Switzerland.

The Committee formulates guidelines and provides recommendations on banking regulation based on capital risk, market risk and operational risk.

Currently there are 27 member nations in the committee. Basel guidelines refer to broad supervisory standards formulated by this group of central banks- called the Basel Committee on Banking Supervision (BCBS).

The set of agreement by the BCBS, which mainly focuses on risks to banks and the financial system are called Basel accord.

The purpose of the accord is to ensure that financial institutions have enough capital on account to meet obligations and absorb unexpected losses. India has accepted Basel accords for the banking system.

- **Credit Risk** - Credit risk is most simply defined as the potential that a bank's borrower or counterparty may fail to meet its obligations in accordance with agreed terms.
- **Market Risk** - Market risk refers to the risk to a bank resulting from movements in market prices in particular changes in interest rates, foreign exchange rates and equity and commodity prices.

❖ BASEL I

Risk management (Focused on Credit Risk, No recognition of operational risk). Capital adequacy, sound supervision and regulation. Transparency of operations – Unquestionably accepted by developed and developing countries – Capital requirement 8% of assets (banks

were advised to maintain capital equal to a minimum 8% of a basket of assets measured based on the basis of their risk) .

Tier 1 capital at 4% &Tier 2 capital at 4%

- **Capital Adequacy Framework**

A bank should have sufficient capital to provide a stable resource to absorb any losses arising from the risks in its business.

Capital is divided into tiers according to the characteristics/qualities of each qualifying instrument. For supervisory purposes capital is split into two categories: Tier I and Tier II.

Tier I capital -Share capital and disclosed reserves and it is a bank's highest quality capital because it is fully available to cover losses.

Tier II capital on the other hand consists of certain reserves and certain types of subordinated debt. • The loss absorption capacity of Tier II capital is lower than that of Tier I capital.

- **The twin objectives of Basel I were:**

(a) To ensure an adequate level of capital in the international banking system &

(b) To create a more level playing field in the competitive environment.

❖ BASEL II

The New Capital Framework. In June 1999, the Committee issued a proposal for a new capital adequacy framework to replace the 1988 Accord. This led to the release of the Revised Capital Framework in June 2004. Generally known as "Basel II",

In 2004, Basel II guidelines were published by BCBS, which were considered to be the refined and reformed versions of Basel I accord.
The guidelines were based on three parameters which are as follows

1) Banks should maintain a minimum capital adequacy requirement of 8% of risk assets.
2) Banks were needed to develop and use better risk management techniques in monitoring and managing all the three types of risks that is credit and increased disclosure requirements.
3) The three types of risk are- operational risk, market risk, capital risk.
4) Banks need to mandatory disclose their risk exposure, etc to the central bank.
5) Basel II norms in India and overseas are yet to be fully implemented.

The New Basel Capital Accord focused on, three pillars viz. – Pillar I - Minimum capital requirement – Pillar II - Supervisory review – Pillar III - Market discipline

Pillar I - Minimum Capital Requirement]

The Committee on Banking Supervision recommended the target standard ratio of capital to Risk Weighted Assets should be at least 8% (of which the core capital element would be at least 4%).

The minimum capital adequacy ratio of 8% was prescribed taking into account the credit risk.However, in India the Reserve Bank of India has prescribed the minimum capital adequacy ratio of 9% of Risk Weighted Assets.

Pillar II - Supervisory Review

The Supervisory review should be carried out in the following manner. – Banks should have a process for assessing their overall capital adequacy – Supervisors should review banks' assessments – Banks are expected to operate above minimum – Supervisor's intervention if capital is not sufficient

Pillar III: Market Discipline

a) Role of the market in evaluating the adequacy of bank capital

b) Streamlined catalogue of disclosure requirements
c) Close coordination with International Accounting Standards Board
d) In principle, disclosure of data on semi-annual basis the situation,

CAPITAL ADEQUACY RATIO (CAR)?

Capital Adequacy Ratio (CAR) is the ratio of a bank's capital to its risk. It is also known as the Capital to Risk (Weighted) Assets Ratio (CRAR). In other words, it is the ratio of a bank's capital to its risk-weighted assets and current liabilities. This ratio is utilized to secure depositors and boost the efficiency and stability of financial systems all over the world.

Capital Adequacy Ratio Formula

The CAR or the CRAR is computed by dividing the capital of the bank with aggregated risk-weighted assets for credit risk, operational risk, and market risk.

This is calculated by summing a bank's tier 1 capital and tier 2 capitals and dividing the total by its total risk-weighted assets. That is:

Tier 1 CAR = (Eligible Tier 1 capital funds) = (Market Risk RWA + Credit Risk RWA + Operational Risk RWA)

Total CAR = (Eligible Total capital funds) ÷ (Credit Risk RWA + Market Risk RWA + Operational Risk RWA)

CAR Formula:-**CAR = (Tier 1 capital + Tier 2 capital)/risk weighted assets**

Note that two types of capitals are measured here.

Tier 1 capital: This can absorb the losses without a bank being required to stop trading. Also called core capital, this consists of ordinary share capital, equity capital, audited revenue reserves, and intangible assets. This is permanently available capital and readily available to absorb losses incurred by a bank without it having to cease operations.

Tier 2 capital: This can absorb losses if the bank is winding-up and so gives depositors a lesser measure of protection. This consists of unaudited reserves, unaudited retained earnings, and general loss reserves. This capital cushions losses if the bank is winding up and is used to absorb losses after a bank loses all its tier 1 capital.

Risk-weighted assets: These assets are used to fix the least amount of capital that should be possessed by banks to lower the insolvency risk. The capital requirement for all types of bank assets depends on the risk assessment.

➢ Why is Capital Adequacy Ratio important?

The CAR is decided by central banks and bank regulators to prevent commercial banks from taking excess leverage and becoming insolvent in the process. The CAR is important to ensure that banks have enough room to take a reasonable amount of losses before they become insolvent and, as a result, lose depositors' funds.

In general terms, a bank with a high CRAR/CAR is deemed safe/healthy and likely to fulfill its financial obligations.

When a bank is winding-up, depositors' funds are accorded a greater priority than the bank's capital, so depositors will lose their savings only if a bank has a loss higher than the capital it has. So, the higher the CAR, the greater is the protection for depositors' funds with the bank.

The CAR helps keep an economy's financial system stable by ensuring that the risk of banks going insolvent is low.

➢ What is the current Capital Adequacy Ratio in India?

The Basel III Norms have prescribed a CAR of 8%. In India, the Reserve Bank of India (RBI) mandates the CAR for scheduled commercial banks to be 9%, and for public sector banks, the CAR to be maintained is 12%

REVISED NPA NORMS- GRIEVANCE MECHANISM

1) The Reserve Bank of India (RBI) on Friday issued a new framework for resolution of bad loans, replacing the previous norms quashed by the Supreme Court in April, offering a 30-day gap for stress recognition instead of the one-day default earlier.
2) The new norms replaces all the earlier resolution plans such as the framework for revitalizing distressed assets, corporate debt restructuring scheme, flexible structuring of existing long-term project loans, strategic debt restructuring scheme (SDR), change in ownership outside SDR, and scheme for sustainable structuring of stressed assets (S4A), and the joint lenders' forum with immediate effect.

3) The apex court on April 2 struck down the stringent RBI circular, issued on February 12, 2018, for resolving bad loans under which a company could be labelled an Non-performing asset (NPA) if it missed repayment for a day banks were asked to find a resolution within 180 days or else it should be sent to bankruptcy courts.

4) The new circular provides for a framework for early recognition, reporting and time-bound resolution of bad loans.

BANKING OMBUDSMAN (BO)

What is Banking Ombudsman (BO)?

- He hears customers' complaints against banks.
- BO was first setup in UK.
- In India, RBI started this scheme in 1995.

Appointment & Tenure

- Earlier RBI used to appoint reputed persons from banking, finance, management, legal etc. sectors as Banking Ombudsmen (BO).
- But now RBI has reserved this BO post for its own Chief General Managers and General Managers.
- Tenure: 3 years at a time.
- Reappointment: yes possible.

Jurisdiction of Banking Ombudsman?

- Banking Ombudsman (BO) Scheme applies to whole of India (including Jammu and Kashmir).

Banking Ombudsman have jurisdiction over

1. All commercial banks (scheduled and non scheduled, public and private)
2. Regional rural banks
3. scheduled primary co-operative banks
4. NBFCs (BO's Jurisdiction limited to "loan" part.)

- Banking Ombudsman is not a replacement of Consumer forum/courts. He merely supplements them.
- Banking Ombudsman deals with matters less than or equal to Rs.10 lakhs.
- Here are some examples situation where BO can help you:

Regular banking

1. Demand draft, cheques, pay orders etc. not issued on time. (or not paid on time)
2. Credit card related complaints (e.g. bank putting hidden charges. Your credit card was stolen but bank did not disable it even after you called them.)
3. You asked the bank to close your account / credit card but they are not doing it.
4. Bank refuses to open your account without giving valid reasons.
5. Bank closes down your account without valid reasons.
6. Government / your company deposited salary / pension in your account but the bank is not releasing it on time.
7. Bank is taking out money from your account in pretext of some flimsy charges.
8. Branch office notice board says "10.30 to 5" but staff refuses to provide you service after 3.30PM.
9. NRIs having bank account in India and facing problems about remittances etc. (e.g. he deposited money from America, but his parents are not given money on time.)

Loans

1. Your loan application is not processed in time.
2. Your loan application is rejected without valid reasons.
3. You loan application is accepted but money is not released in time. (and still bank is charging interest on it!)
4. Bank doesn't follow RBI guidelines regarding loan-recovery agents (e.g. bank hires some criminals to bully and harass you.)
5. Bank doesn't follow RBI guidelines regarding loan interest rates.

Procedure for getting justice?

- You're unhappy with the bank for xyz reason. But you cannot directly approach BO.
- First you've to give written complaint to the concerned bank that "I've so and so problem."
- and IF the bank doesn't deal with your complaint within one month, then you can approach BO.
- On the other hand, you cannot approach BO if the matter is older than 1 year.
- You don't need lawyer to approach BO.
- You don't need to pay any fees/ stamp papers for approaching BO.

You can't approach BO in following situations

1. Matter is higher than Rs.10 lakh.
2. If the matter is pending before any other court, tribunal, forum then you cannot approach BO.
3. If any other court, tribunal, forum has already passed an order on the same matter.
4. You cannot approach BO for frivolous or vexatious complaints (e.g. AC or water cooler was off when I went to the branch. Someone jumped the queue but security guard did nothing….)

How does BO settle complaint?

- Upon receiving your complaint, first Banking Ombudsman will try to solve the matter via settlement /arbitration (=try to achieve a compromise, conciliation or amicable solution between bank and its customer.)
- This has to be done within one month after receiving complaint.
- But if either party (customer/bank) is not accept this (compromise/negotiation/settlement) then after 1 month, Banking Ombudsman will have to pass "order".

- Now, he'll ask both parties to present their case/documents etc. And he'll pass the order accordingly.
- Two things can happen

1. He rejects your complaint (=bank is not guilty). OR
2. He finds the bank guilty and orders punishment.

Punishment

- Banking Ombudsman (BO) can order the Bank to compensate the actual money loss OR Rs.10 lakh (whichever is lower).
- In case of Credit card related cases, BO can order the bank to pay additional fines (**upto Rs.1 lakh**) for the mental harassment caused to the customer.

Appellate authority for Banking Ombudsman

- If either party (Bank / Customer) is unhappy with Ombudsman's order, then they can approach the Appellate authority (=Deputy Governor of RBI.)

1. If you're the customer, you can directly approach him.
2. But if you're the "Bank", then you can approach him only after getting permission from your Chairman/CMD/MD or CEO. (This ensures Bank's lower staff doesn't automatically go for frivolous appeals against every order).

IMPACT OF REFORMS.

The ill health of the banks and financial institutions has been one of the important reasons for the initiation of the financial sector reforms, as indicated by the extent of profits and the Non-Performing Assets. The public sector banks have been the major contributors, in the past to the losses and mounting Non-Performing Assets incurred by the financial system. These indicators, however, have shown some improvement in the recent years, though there is much to be achieved. Both the operating and net profits have recorded significant improvements. For instance the net profits as per cent to total assets of all the Public Sector Banks has moved up from 0.27 in 1991 to about 0.6 in the late 1990s. Thanks to the strict

adherence to the capital adequacy and prudential norms and increased competition from the private sector.

The extent of Non-Performing Assets is the other important indicator of thefinancial health. Though the gross and the net Non-Performing Assets of the scheduled commercial banks have gone up in the recent years (except foreign banks), the same in relative terms i.e., as a per cent of advances and total assets have shown a declining trend. The gross Non-Performing Assets as per cent of total assets have declined from 4 per cent in 1994-95 to about 3 per cent in the late 1990s.

One of the important planks of financial liberalization has been the dismantling of administered interest rate regime and the progressive movement towards market determined interest rate regime. The progress has been gradually but definite. Ever since the process began, there has been continuous southward movement in the nominal rates. Importantly, the real interest have turned positive (and are increasing) thus getting freedom from the clutches of the financial repression. Though this means high cost of funds for the corporate sector, there is no cause for worries, the corporate sector now has the option of raising funds from the capital market both domestic and international). Moreover, the positive real interest rates has augured well for the savings, as seen in the increase in private sector savings from about 20 per cent in 1991-92 to about 25 per cent 2000-01.

➢ IMPLICATIONS

However, despite the widening and deepening of the financial sector in India over the years still the Indian financial sector suffers from some drawbacks.

Firstly, there has been a steady erosion of operational efficiency in the financial sector despite commendable progress.

Secondly, the financial sector in our country, suffers from many shortcomings such as insufficient banking system and mobilization of resources, inadequate operation in respect of rural areas and weaker sections, weak performance, low profitability rates, low efficiency, poor customers services, insufficient care in selection, recruitment, training and promotion of staff, laxity on the part of supervisory staff. In other words we find that, financial development in India has ignored the qualitative approach. Also, the Indian financial sector lacks sufficient modernization and introduction in the portfolio quality.

Similarly, the capital markets, which have shown an impressive growth in the volume of operations, they have suffered from many deficiencies in regard to their efficiency and the quality of their operations.

Some of the above reforms recommended by the Committee have been implemented in a phased manner but there are several areas where the reforms are yet to be implemented. The financial sector reforms initiated since 1992-93 have altered the course of working of public sector banks. However, there are some areas which affect the health of the public

sector banks viz., non-performing assets, unviable operations at rural and semi-urban centres, pre-emptions of resources through SLR and CRR. The loss making banks and branches are either to be closed or merged. While, over the years both, the banking system and the capital market, have shown impressive growth in volume of operations. The supervisory system of the Reserve Bank of India is being strengthened with the establishment of a new Board for financial bank supervision with the Reserve Bank of India under the exclusive charge of Deputy Governor. The regulated interest rate structure is being nationalized and simplified. Bank deposit rates have been deregulated subject to a ceiling rate.

Some of the other measures adopted in pursuance of the reforms are doing away with the licensing system for opening up of new bank branches, quicker and further liberalization of the capital, framing rules for the SEBI etc. More freedom has been given to banks in various fields of their operation.

The other reforms in the banking sector are automation and staff restructure which are going on at present by introducing ATM and Voluntary Retirement Scheme tothe employees. The VRS scheme has been very successful in banks like State Bank of India.

On 31st January 2001, SBI found to its embarrassment that 33,000 of its 2.30 lakhs strong work force have opted for the scheme. The large number of people opted out are mostly below 55 years of age. But the bank decided to accept the cases of those who are above 55 years of age.

Until 1991, there was little competition in the banking sector. The public sector banks dominating the banking industry in terms of size of assets, acted as a monolith. The government has now recognized the need to make banking industry more competitive. It has thus made certain policy changes such as deregulation of interest rates and dilution of consortium lending requirements. Moreover, banking has been opened up to the private sector banks have started functioning. In all 28 foreign banks are presently operating in India with a network of 155 branches.

Conclusion:-Despite the impressive quantitative achievements in resource mobilization and extending the credit reach, several distortions have crept into the financial systems especially in respect of the allocation of financial resources, productivity and efficiency of the system have suffered, its profitability has been eroded and its quality has deteriorated.

Low profitability, high and growing non-performing assets and relatively low capital base has continued to cause anxiety. In 1991-92 the gross profits and scheduled commercial banks were 0.35 per cent of working funds. The spread between interest earned and paid as a proportion of the working fund was 3.3 per cent and the proportion 'other expenses' to working funds was 2.06 per cent during 1991-92. The rate of growth of earnings has been slower than the rate of growth of business and working funds. The spread between interest earned and paid as a proportion of working fund was 3.3 per cent and the proportion of other expenses to working funds was 2.06 per cent during 1991-92. The rate of growth of earnings

has been lower than the rate of growth of business and working funds. There has been a decline in the quality of loan assets. In the light of internationally accepted standards relating to capital adequacy, bad debt provision and income recognition the banking system is indeed bankrupt. Customer services has been poor, work technology remain outdated and transaction costs are high. The system had not been able to perform its vital functions relating to:

a) resource allocation based on sound criteria,
b) improvement in the productive and investment efficiency of assisted enterprises, and
c) Reduction of transaction costs and risks of depositors, borrowers and the financialinstitutions.

IMPORTANT QUESTION:-

❖ SHORT QUESTIONS (2 MARKS):-

1) Define monetary policy
2) Define BASEL norms II
3) Capital adequacy ratio
4) Define Reserve Bank Of India
5) Define Verma committee
6) Banking Ombudsman
7) Non-Performing Assets
8) Narasimham committee
9) Monetary Policy
10) Credit control

❖ LONG QUESTIONS (10 MARKS):-

1) Define RBI? Explain the Functions & Structure of RBI?

2) Define Monetary Policy? Discuss its objectives & instruments of monetary policy?

3) Write the Short notes:-
   a) Techniques of credit control
   b) Banking ombudsman

4) Discuss the impact of RBI reforms in banking sector in detailed.

5) Explain the Reforms of RBI in detailed

6) Write the Short notes:-
   a) Narasimham committee

b) Capital adequacy ratio

7) Write the Short notes:-

a) BASEL norms II

b) Verma Panel Report

UNIT-III
E-BANKING

INTODUCTION OF E-BANKING

Electronic banking has many names like e banking, virtual banking, online banking, or internet banking. It is simply the use of electronic and telecommunications network for delivering various banking products and services. Through e-banking, a customer can access his account and conduct many transactions using his computer or mobile phone. In this article, we will look at the importance and types of e-banking services.

MEANING OF E-BANKING

E-banking refers to the process of using banking services online over the internet. It is a technique through which customers avail all services of banks through the internet. It is also termed as internet banking, electronic banking & virtual banking.

Customers are easily able to access their accounts & perform various financial transactions just by using their phones & laptops. It is all possible because of e-banking. It saves the time of customers & provides 24×7 service.

Customers can use their banking services any time & from anywhere through the e-banking feature. E-banking service all operate through the transmission of electronic signals between customer device & website of their banks.

E-banking services are of different types like Telebanking, smart cards, ATMs, E-cheques & debit cards. Customers are able to secure their account & protect them from frauds using e-banking service.

They can easily monitor their account continuously. It also reduces the workload & operation cost of banking organizations. E-banking has also reduced the chances of human errors as there is no possibility of errors occurring in a fully automated system.

FEATURES OF E-BANKING

1. Faster Transactions:- E-banking provides the facility of instant transfer of funds to its customers. It saves the time of customers as funds get transferred very fast from one account to another. Whole system of E-banking is automated & works over the internet.

People don't need to wait in queue to transfer their funds or pay off their bills; they can easily do it through their device. It saves the time of customers as they can easily access their account with the help of their device.

2. Lowers Transaction Cost:- E-Banking reduces the cost involved in doing financial transactions. Electronic transactions are termed as the cheapest medium of doing transactions. It has reduced the manpower requirements as workload is reduced.

Whole transactions are done online over the internet. It has also reduced the paperwork in organizations as all transactions are recorded digitally. There is no need to manually enter & store each record.

3. Provides 24×7 Service:- This is the most important feature of E-banking. E-Banking provides customers with all-time access facility to their accounts. Customers can easily access their account anytime & from anywhere with no limitations. It provides convenience to the customers as they can perform transactions as per their wish.

4. Reduces The Chances Of Error:- E-banking has reduced the chance of human error. It has reduced the role of the human in the whole transaction process. E-banking system works fully automated over the internet. All transactions are recorded & stored digitally. There is no need to manually maintain each & every record in books of account. So, the chances of human error are minimized.

5. Develops Loyalty In Customers:- E-banking helps the banks to develop large number of loyal customers. Through E-banking service banks are able to serve their customers well. They are able to provide fast & better service to customers.

Customers are able to get a user-friendly interface from the banking website. They are able to avail services any time even from their home comfort. This develops a sense of loyalty among customers when they are happy with the services of their banks.

6. Removes Geographical Barriers:- E-Banking has removed all distance barriers for performing transactions. It has removed all distance barriers that customers used to face in the traditional method of performing transactions.

E-banking provides the facility of instant transfer of funds both nationally & internationally. All systems are connected to each other online which facilitate easy transfer of funds.

7. Provides Better Productivity:- It has an efficient role in increasing the productivity of the businesses. Whole financial transaction system is supported by

automated software systems. These systems are specially designed for doing transactions of funds.

It reduces the time required for doing transactions & also reduces the workload of business organizations. Everything is stored digitally & they don't need to store anything manually. It increases the overall productivity of the businesses.

8. Reduce Frauds In Transactions:- Another important feature of e-banking is that it helps in continuously monitoring of accounts. You can easily track each & every transaction of your accounts. You can easily track if any fraud is done by anyone in financial transactions.

It provides a complete digital footprint of all those who can modify your banking activities & commit fraud. It thereby adds transparency to your accounts which reduces the overall chances of fraud

TYPES OF E BANKING SERVICES

Banks offer various Types Of Services through electronic banking platforms. These are of three types:

Level 1 – This is the basic level of service that banks offer through their websites. Through this service, the bank offers information about its products and services to customers. Further, some banks may receive and reply to queries through e-mail too.

Level 2 – In this level, banks allow their customers to submit instructions or applications for different services, check their account balance, etc. However, banks do not permit their customers to do any fund-based transactions on their accounts.

Level 3 – In the third level, banks allow their customers to operate their accounts for funds transfer, bill payments, and purchase and redeem securities, etc.

IMPORTANCE OF E-BANKING

We will look at the importance of electronic banking for banks, individual customers, and businesses separately.

- **Banks**

1. **Lesser transaction costs –** electronic transactions are the cheapest modes of transaction
2. **A reduced margin for human error –** since the information is relayed electronically, there is no room for human error

3. L**esser paperwork –** digital records reduce paperwork and make the process easier to handle. Also, it is environment-friendly.
4. **Reduced fixed costs –** A lesser need for branches which translates into a lower fixed cost.
5. **More loyal customers –** since e-banking services are customer-friendly, banks experience higher loyalty from its customers.

- **Customers**

1. **Convenience –** a customer can access his account and transact from anywhere 24x7x365.
2. **Lower cost per transaction –** since the customer does not have to visit the branch for every transaction, it saves him both time and money.
3. **No geographical barriers –** In traditional banking systems, geographical distances could hamper certain banking transactions. However, with e-banking, geographical barriers are reduced.

- **Businesses**

1. **Account reviews –** Business owners and designated staff members can access the accounts quickly using an online banking interface. This allows them to review the account activity and also ensure the smooth functioning of the account.
2. **Better productivity –** Electronic banking improves productivity. It allows the automation of regular monthly payments and a host of other features to enhance the productivity of the business.
3. **Lower costs –** Usually, costs in banking relationships are based on the resources utilized. If a certain business requires more assistance with wire transfers, deposits, etc., then the bank charges it higher fees. With online banking, these expenses are minimized.
4. **Lesser errors –** Electronic banking helps reduce errors in regular banking transactions. Bad handwriting, mistaken information, etc. can cause errors which can prove costly. Also, easy review of the account activity enhances the accuracy of financial transactions.
5. **Reduced fraud –** Electronic banking provides a digital footprint for all employees who have the right to modify banking activities. Therefore, the business has better visibility into its transactions making it difficult for any fraudsters to play mischief.

- **<u>HOW DOES ONLINE BANKING WORK?</u>**

1) **Open Accounts:** Now there is no need to go to the bank branch personally in order to open your bank account. You can open bank accounts of any type –savings, current, or other any other account online using the online banking feature.
2) **Pay Bills Online**: Gone are the days of waiting in long queues at government offices to pay your bills. Now, you can pay your bills easily with just a few simple clicks using the Internet Banking option.
3) **Transfer Funds**: Wish to transfer funds to someone? Need to carry it out urgently? There is no need to worry as you can transfer funds from your bank account to the other account instantly & seamlessly. You can even link bank accounts to different online wallets that can be used for transferring funds with no or minimum transfer rates.
4) **Apply for Loans**: Loans include intense paperwork that might appear a daunting task to many. Now, with just typing your relevant information and carrying out some vital proceedings, you can apply for different types of loans using the net banking
5) **Obtain Better Rates:** Banks that function online are known to be offering better rates. Thus, you can utilize the online banking system to get better rates on your savings.

➢ **Net Banking Features Simplifying Your Life**

When you make use of the net banking services, here are some features offered that could make your life simple:

1) **Ease of Account Creation**: Fed up of visiting the bank branch every time & standing in long queues while creating an account? With net banking, you can open an account online with a few simple clicks.
2) **Get Electronic Statement:** Reduce the waste of paper by getting e-statements on your mobile phone through SMS or emails.
3) **Automatic Bill Payments**: Never pay extra fine for delayed bill payments now! With net banking, pay your bills every month automatically & seamlessly.

THREE MAJOR MEANS OF TRANSFERRING MONEY

1. NEFT (National Electronic Fund Transfer)

The National Electronic Fund Transfer or NEFT is the simplest and most liked form of money transfer from one bank to bank.

To make any NEFT transaction, two important pieces of information is needed -- firstly, **account number** and secondly, **the IFSC Code** of the destination account.

In NEFT, there is no cap on the amount of money that can be transferred. However, individual banks may set a limit.

- **STEPS FOR A NEFT MONEY TRANSFER**

Step 1: Go to Fund Transfer tab, and select 'Transfer to other bank' (NEFT)
Step 2: Select the recipient account and enter the relevant details
Step 3: Accept the (Terms and Conditions)
Step 4: Recheck the details, if all and complete the process

2. RTGS (Real Time Gross Settlement

A Real Time Gross Settlement or RTGS is almost similar to NEFT but the minimum payment and how it credits to the destination account differs. If you want to transfer more than 2 then you can use this. There is no upper cap on the amount.

An RTGS money transfer happens on a real-time basis. The bank of the person to whom the money is transferred gets 30 minutes to credit it to his/her account.

- **STEPS TO MAKE RTGS FUNDS TRANSFER:**

Step 1: Go to Fund Transfer tab, and select 'Transfer to other bank' (RTGS)

Step 2: Select the recipient account and enter the relevant details

Step 3: Accept the (Terms and Conditions)

Step 4: Recheck the details, if all are correct, then confirm and complete the process

3. IMPS (Immediate Payment Service)

Immediate Payment Service or IMPs an instant fund transfer service and it can be used anytime. IMPS can be simply defined as NEFT+RTGS.

In order to avoid fraud complaints, the cap on transaction limit is set very low. For IMPS transfer, you just need to know the destination account holder's IMPS id (MMID) and his/her mobile number.

- **STEPS TO MAKE IMPS MONEY TRANSFER:**

Step 1: Using your Customer ID and Password into Net Banking/Mobile Banking
Step 2: Go to Funds Transfer tab (Other Bank Account)
Step 3: Select Debit / Credit Account, mode of transfer as IMPS and beneficiary account
Step 4: Enter the amount to be transferred and click on Submit
Step 5: Click on the confirm button
Step 6: Recheck all the information and approve the transaction using OTP (one time password) received on your registered mobile number
Step 7: And at last, confirm by clicking on the submit button.

Through IMPS, you can transfer money 24/7, But RTGS & NEFT can be done only in working hours on weekdays + a few hours on Saturdays only.

- **Other than NEFT, RTGS and IMPS, you can also transfer your money through UPI and cheque.**

1. UPI (Unified Payments Interface):- A Unified Payments Interface is a real-time payment system that allows transactions to be done through any Smartphone using VPA (Virtual Payment Address).
No bank account detail is needed for the money transfer through UPI. Only mobile number or name is sufficient and the transactions can be done 24/7. UPI-enabled apps allow the transfers up to Rs 1 lakh.
2. Cheque:- You can transfer money from your one account to another account by cheque. You have to simply draw a stating payee as your name along with the account number wherein you want to transfer the amount along with your signature.
It's done immediately at a branch if the transfer is within your bank.
There is no limit if you want to transfer money from your a/c to another bank a/c, but if you want to withdraw a certain amount, there are restrictions.

E-BANKING IN INDIA

In India, since 1997, when the ICICI Bank first offered internet banking services, today, most new-generation banks offer the same to their customers. In fact, all major banks provide e-banking services to their customers.

Popular services under e-banking in India

- ATMs (*Automated Teller Machines*)
- Telephone Banking
- Electronic Clearing Cards
- Smart Cards
- EFT (*Electronic Funds Transfer*) System
- ECS (*Electronic Clearing Services*)
- Mobile Banking
- Internet Banking
- Telebanking
- Door-step Banking

ADVANTAGES OF E-BANKING

All the advantages of e-banking are closely related to each other; from convenience to efficiency, we list out 10 advantages of net banking.

1. Benefits and Rewards:- A lot of online banks offer more benefits and rewards to their customers that not only benefit the bank but also benefit their customers.

Online banks are willing to offer higher interest rates and better transfer services to their customers who regularly use online banking.

This happens partly due to the fact that the banks have to bear reduced costs when serving online customers.

Therefore, the overall banking experience is obviously better than that of visiting a physical bank branch and handling the same transaction.

2. Notifications and Alerts:- Customers are instantly alerted or notified about new changes in the system.

From changes in the policy to logins from new devices, customers get instant notifications and alerts.

However, if you're associated with a real bank, you would probably get a text alert or a customer service agent will call you to notify about major changes. Chances are, you're missing out on a lot of changes.

Banks also endorse new products, services and schemes like new investment options, changes in the loan policies, etc. to online customers first.

3. Faster Transactions:- You don't have to wait for your turn to transfer funds – you can do that with a single tap of your finger or a single click of your mouse.

Funds from one account will be transferred to another in a matter of a few seconds. Anything that requires quick payments can be done with the help of e-banking.

For instance, you are required to immediately pay your child's school fees. You can do it via the bank's app or website or you can physically go to the bank to withdraw cash and then going to the school to deposit the fees.

You'll probably end up wasting half the day to perform this transaction which with the app's help could've been performed in a matter of minutes.

4. Convenience:- You can conveniently handle your account transactions without all the hassle of being in the queue on a sultry afternoon.

E-banking is extremely convenient if you have a decent internet connection (wifi or 3G/4G data).

You can access the website from anywhere without actually having to visit the bank. If your banking needs don't involve the assistance of any staff member or a manager, online banking is the best option for you.

5. Security:- With internet banking, you can always monitor your account activities.

This not only serves as a history of all the transactions but also helps you identify threats and suspicious activities before any severe damage can be done to your account.

Online accounts are protected with encryption software that ensures complete safety to the user. Alerts related to passwords and digital signatures are sent periodically to maintain the security of the account.

6. Easy Access:- Customers can enjoy easy access with online accounts by simply typing in the log-in credentials. In addition to that, customers can also handle several accounts at a time.

Since the internet remains the medium of connection, users can also access different accounts in different banks from a single device.

7. Speed and Efficiency:- In a hurry to apply for an educational loan? Or quickly need to pay bills? Or perform any banking transaction without having to waste half your day? Do it via the internet.

There's no waiting nor do you have to rush through anything – you can take your time and perform all banking transactions with patience and it will be done in nearly 1/10th the time spent on actually driving down to the bank and getting it done.

8. Lesser Limitations:- Traditional banks have several constraints like operating hours, the physical location of the bank branch, holidays, etc.

You don't have to wonder if it's a holiday with online banking, or what time is it to perform a transaction.

Be it Sunday or the middle of the night and you will still be able to do everything (and even more) through their app or website as it's available twenty-four hours a day, throughout the year.

9. More Features:- Apart from being flexible, some banks go out of their way to satisfy their customers by not penalizing on withdrawals on the certificate of deposits, letting customers maintain accounts with no minimum balance, etc.

Moreover, banks generally offer more offers and discounts on credit and debit cards used by customers who have online accounts.

10. Better Customer Service:- Banking websites and apps come with customized web pages to solve customer queries and often have a dedicated 'Frequently Asked Question' (FAQs) section that helps in answering common customer queries.

You can chat with a customer service agent or call them if you need more help. This not only saves the time of the customers but also that of the bank employees who can shift their focus to more important things.

DISADVANTAGES OF E-BANKING

Similarly, there are some limitations of net banking; from security to technology issues, we list out 10 disadvantages of net banking.

1. Difficult for Beginners:- Newbie's often face difficulty in trying to get the hang of e-banking.

Initially, customers are scared of losing their money and are often hesitant to explore all the options and features that are available on the website or on the app.
New users often give up and stick to traditional banking if timely assistance isn't provided.

2. Trust and Responsibility:- Fake websites and phishing sites are common in this age of technology. Can you really trust all websites? Is it wise to trust an online site with all your money? What if the website folds up and all your money is gone? This wouldn't happen in a real bank.

There is trust between the bank and their customers – you know your money is safe with the bank – because they take responsibility for your money. Real banks are permanent and reliable while some websites are not.

3. Inconvenience:- Sure, online banks are open throughout the year but they are a serious cause of inconvenience in certain instances.

For example, if you get locked out of your account you will be unable to perform any banking transactions.

However, in a real bank, you establish relationships with the staff, who know you on a personal level and will be willing to assist you in such cases.

You wouldn't have to be on the phone explaining your situation to an unknown customer service agent which by the way, might also take several days.

Also, a few online banks don't allow cash deposits. To deposit cash, you will be required to email a check and transfer money from another account or bank, or use their e-check deposit service.

4. Inability to Handle Complex Transactions:- While you can easily pay bills and transfer funds, you can't perform complex transactions online.

When a large sum of money is involved, it is advisable to visit a real bank and sort it out in-person rather than doing it online.

Some financial transactions also need a document verification (like buying a house) so it is better to submit them physically than digitally.

5. Financial Jargon:- Financial jargon can often get between you and your money. Knowledge is power-or, in this case, knowledge is money.

Though financial literacy can't be achieved overnight, it can be helped along by a grasp of the basic terms that are commonly used by advisors, analysts, economists, and commentators.

6. Security Issues:- Sure, most banks are well-reputed and established, there are times when you face security issues.

There's always a risk of actual and/or identity theft. It's also possible to get unauthorized access to your account via a stolen or hacked log-in credentials.

7. Technology Issues:- If you don't have a decent connection or there are bugs in the software, or say, there is a power cut or maybe the servers have gone down – websites are bound to crash and you will undoubtedly face a lot of technological issues.

While you may get various types of customer service at the moment but sooner or later, you will get frustrated. However, someone is always around to help you in a real bank.

8. Virtual Assistance:- When you need assistance during e-banking, your concern is generally assigned to an anonymous customer service agent who is unlikely to know you.

Wouldn't you rather talk to a personal banker when you're in a fix than an unknown agent?

A personal banker will also know your transaction history, your personal details and will be in a better position to assist you.

9. Complicated Websites:- Some websites look like a page straight from a super complex scientific experiment. Written in a secret code language with bizarre fonts and colors.

I mean, sure some websites are simple and you can get all the things done in a jiffy.

But some websites are downright complicated and confusing. With pop-ups, errors, links, and interlinks, redirections to probably a million pages, it gets really difficult to understand.

10. Other Limitations:- E-banking isn't for everyone. Illiterate and the elderly cannot use online banking. Neither can an individual access their accounts if they don't have an internet connection.

MOBILE BANKING

HISTORY OF MOBILE BANKING

Before the introduction and enablement of mobile web services in 1999, mobile banking was completed primarily through text or SMS; it was known as SMS banking. European banks were on the frontier of mobile banking service offering, using the mobile web via WAP support.

SMS banking and mobile web were the most popular mobile banking products before 2010. With the development of Smartphone's with iOS or Android operating systems, mobile banking applications (apps) began to evolve. Clients were able to download the banking apps onto their Smartphone's with more sophisticated interfaces and improved transactional abilities.

To date, many financial institutions make use of both SMS and mobile applications to keep their clients informed of their account activities or to send out alerts regarding possible fraud and/or updates and maintenance of service provision.

Examples can be a text message from a bank, notifying users that their ATMs or apps will not be accessible during a particular time period due to system maintenance, or a confirmation text from the bank regarding a transfer carried out by the client via the mobile app.

Meaning of Mobile Banking

Mobile banking refers to the use of a mobile device to carry out financial transactions. The service is provided by some financial institutions, especially banks. Mobile banking enables clients and users to carry out various transactions, which may vary depending on the institution.

Currently, mobile banking's become easier with the development of cellular mobile applications. Clients are now able to check their balances, view their bank statements online, make transfers, and even carry out prepaid service purchases.

FEATURES OF MOBILE BANKING

These features should include:

1. 24-hour access to account balances, account history, and transactions
2. Secure mobile check deposit, using the Smartphone camera
3. Bill payments
4. Loan payments
5. Money transfers
6. Security and fraud alerts
7. Travel services

TYPES OF MOBILE BANKING

There are three types of mobile banking services offered to customers:

1. Mobile Banking over SMS: This form is also known as SMS banking. It allows customers who do not have access to the internet to check their bank account balance and receive a mini account statement among others. Just choose to sign up with your bank for the service and register your number with the bank account.

2. Mobile Banking over WAP (Wireless Application Protocol): Customers who wish to avail this service can download the official banking app released by the concerned bank on their Smartphone. Once downloaded, customers will be required to register for mobile banking services. Upon receiving their login credentials from the bank, mobile banking services can be used.

3. Mobile Banking over USSD (Unstructured Supplementary Service Data): Banks also offer mobile banking services to customers who do not have access to the internet or a Smartphone. Customers are provided with USSD codes. Customers can avail services, such as account balance enquiry and mini account statement, on their phone. Over the years, mobile banking with USSD has become one of the most commonly used methods in rural areas.

CATEGORIZED OF MOBILE BANKING SERVICES

Mobile banking services can be categorized into the following:-

1. Account information access:- Account information access allows clients to view their account balances and statements by requesting a mini account statement, review transactional and account history, keep track of their term deposits, review and view loan or card statements, access investment statements (equity or mutual funds), and for some institutions, management of insurance policies.

2. Transactions:- Transactional services enable clients to transfer funds to accounts at the same institution or other institutions, perform self-account transfers, pay third parties (such as bill payments), and make purchases in collaboration with other applications or prepaid service providers.

3. Investments:- Investment management services enable clients to manage their portfolios or get a real-time view of their investment portfolios (term-deposits, etc.)

4. Support services:- Support services enable clients to check on the status of their requests for loan or credit facilities, follow up on their card requests, and locate ATMs.

5. Content and news: - Content services provide news related to finance and the latest offers by the bank or institution.

CHALLENGES ASSOCIATED WITH MOBILE BANKING

Some of the challenges associated with mobile banking include (but are not limited to):

1. Accessibility based on the type of handset being used
2. Security concerns
3. Reliability and scalability
4. Personalization ability
5. Application distribution
6. Upgrade synchronization abilities

ADVANTAGES OF MOBILE BANKING

1) It utilizes the mobile connectivity of telecom operators and therefore does not require an internet connection.
2) With mobile banking, users of mobile phones can perform several financial functions conveniently and securely from their mobile.
3) You can check your account balance, review recent transaction, transfer funds, pay bills, locate ATMs, deposit cheques, manage investments, etc.
4) Mobile banking is available round the clock 24/7/365, it is easy and convenient and an ideal choice for accessing financial services for most mobile phone owners in the rural areas.
5) Mobile banking is said to be even more secure than online/internet banking.

DISADVANTAGES OF MOBILE BANKING

1) Mobile banking users are at risk of receiving fake SMS messages and scams.
2) The loss of a person's mobile device often means that criminals can gain access to your mobile banking PIN and other sensitive information.
3) Modern mobile devices like Smartphone and tablets are better suited for mobile banking than old models of mobile phones and devices.
4) Regular users of mobile banking over time can accumulate significant charges from their banks.

ELECTRONIC FUNDS TRANSFER

ELECTRONIC FUNDS TRANSFER

An electronic funds transfer moves money from one account to another electronically over a computerized network. EFTs requires both the sender and recipient to have bank accounts. The accounts do not have to be at the same financial institution to transfer funds. Both individuals and businesses can make EFT payments over the computer, using card readers, or over phones.

EFTs debit (increase) one person's account and credit (decrease) the other person's account.

EFT transactions are also known as electronic banking. Everything is paperless, so there isn't a need for cash or paper checks.

The Electronic Fund Transfer Act (EFTA) regulates electronic funds transfers. The EFTA is a federal law that protects individuals who make EFT payments. For example, the EFTA requires financial institutions to provide consumers with a summary of rights and notifications of unauthorized transactions.

➢ EFT vs. ACH

You might be wondering what the difference between an EFT and ACH (Automated Clearing House) payment is.

ACH is a type of EFT. So, all ACH transactions are types of electronic funds transfers, but not all electronic funds transfers are ACH transactions.

Electronic funds transfers include all types of electronic payments. On the other hand, an ACH payment is made within the Automated Clearing House Network (e.g., payroll and direct deposit).

For example, wire transfers are **not** ACH transactions. Instead, a wire transfer is a type of EFT transaction.

TYPES OF EFT

There are a number of ways to transfer money electronically. Here are just some common EFT payments you might use for your business.

1) **Direct deposit** lets you electronically pay employees. After you run payroll, notify your direct deposit service provider of the amount to deposit in each employee's bank account. Then, the direct deposit provider transfers that money to employee accounts on payday. Not all employers can make direct deposit mandatory, so brush up on direct deposit laws.
2) **Wire transfers** are a fast way to send money. They are typically used for large, infrequent payments (because there's a fee). You might use wire transfers to pay vendors or make a large down payment on a building or equipment.
3) **The Electronic Federal Tax Payment System (EFTPS)** is a tax payment service you can use to make tax payments to the IRS.
4) **ATMs** let you bank without going inside a bank and talking to a teller. You can withdraw cash, make deposits, or transfer funds between your accounts.
5) **Debit cards** allow you to make EFT transactions. You can use the debit card to move money from your business bank account. Use your debit card to make purchases or pay bills online, in person, or over the phone. And, you can accept debit card payments from customers.
6) **Electronic checks** are similar to paper checks, but they are used electronically. You enter your bank account number and routing number to make a payment.
7) **Mobile wallets** let you pay bills, transfer money between accounts, or receive payments over the phone.

8) **Personal computer banking** lets you make banking transactions with your computer or mobile device. You can use your computer or mobile device to move money between accounts.

HOW DOES AN EFT PAYMENT WORK?

You might want to send an EFT payment to someone. Or, you may give customers the option to pay you via an electronic funds transfer.

To make an EFT payment, the sender must know the recipient's bank account information. If you're making an EFT payment, you must authorize the funds transfer. Then, the money is taken from your account and deposited into the recipient's account.

There might be a fee for some EFT transactions. **For example,** you might have to pay for certain ATM transactions. However, other transactions might be free.

EFT PAYMENT PROCESSING TIME

The amount of time needed to process an EFT payment depends on:

- ✓ The type of payment
- ✓ Your EFT provider
- ✓ When you submit the payment

Your EFT payment might take anywhere from **one to four days**. Some electronic funds transfers are sent and received on the same day (e.g., wire transfers).

EFT payments typically only process on business days. And, there might be certain cut off times.

For example, you might need to make an electronic money transfer before 9 p.m. If you place the transaction after that time, the transaction won't begin until the next business day.

CAN YOU STOP AN EFT PAYMENT?

Normally, you cannot stop an EFT payment after you initiate it. The EFTA does not give you the right to do so. If you need to stop a payment or have your money refunded, that is between you and the person you paid.

However, you might be able to stop scheduled, recurring EFT payments (e.g., scheduled utility EFTs). You can stop an upcoming scheduled payment by notifying your financial institution at **least three business days** before the next scheduled transfer takes place.

Follow your financial institution's policies for stopping scheduled transfers. Otherwise, your stop might be void. Your state might also have additional regulations, so be sure to check your state laws.

ADVANTAGES OF EFT

Electronic funds transfer provides an easy, cheaper, and faster method of transferring money.

1) It helps individuals and organizations to save on costs such as printing checks as well as the time to deliver or collect checks and deposit them in the banks for processing.
2) The money moves to the recipient's account much faster since there is no manual moving of checks from one bank to the other.
3) It is more efficient
4) Has less administrative procedures, hence reduced labor and staff costs
5) An electronic funds transfer is much safer and secure. For instance, it eliminates the need to carry huge amounts of money.

DISADVANTAGES OF EFT

However, there are a few drawbacks too as far as EFTs are concerned. Some of them are:

1) Highly technical. Not for everyone
2) Fear of account being hacked
3) Enhanced privacy breach risk
4) Limit on daily transactions
5) Limit on the maximum amount to be withdrawn daily
6) Chances of identity theft by unscrupulous elements
7) Needs a computer terminal or access to the internet at all times
8) Crimes like phishing, credit cards theft have increased
9) Leads to impulse buying behavior
10) Not for illiterates
11) Fraudulent bank websites are on the rise
12) Dependency on the power supply
13) Some might prefer paper money to "virtual currency"
14) Decreased human interactions
15) Over-reliance on technology

TYPES OF ELECTRONIC FUNDS TRANSFER IN INDIA

Post demonetization, people prefer to transfer money using electronic fund transfer methods. The popularity of electronic payment options is sharply increasing as it allows users to transfer funds online using their mobiles and laptops, from the comfort of their homes and offices. Moreover, it eliminates geographical barriers and helps them transfer money in a hassle-free manner by simply using the IFSC Codes.

For instance, if you are transferring money to an HDFC Bank in New-Delhi's Vasant Vihar Branch, you will need to provide HDFC Bank IFSC Code of that particular area.

But it can be confusing to decide the best method of transferring the money. Taking into the consideration factors like transfer limit, time, cost etc. you can make the right choice.

Listed below are some of the electronic methods, which can be used to transfer money between two accounts -

- ✓ The Transaction between your own linked accounts of the same bank
- ✓ The Transaction between different accounts of the same bank.
- ✓ Transferring money through NEFT into a different bank's accounts
- ✓ Transferring money through RTGS into other bank accounts
- ✓ Transferring money through IMPS into various accounts

1. Using NEFT:- National Electronic Funds Transfer or NEFT is the most commonly used online payment option to transfer money from one bank account to another. Usually, salary transfers by companies are done using NEFT.

The funds are transferred on a deferred settlement basis, which implies that the money is transferred in batches. There is no maximum limit but this depends from one bank to another. For instance, the retail banking limit set by SBI is Rs. 10 lakhs.

Cost Involved:- For transferring money to a different bank, Rs 2.50 to Rs 25 can be charged, based on the amount being transferred.

Constraints:- The money can be transferred only during the bank working days. The transactions cannot be completed over the weekends and on bank holidays. It will be completed on the next working day. Thus, you cannot make instant transactions using NEFT.

Requirements-

- ✓ Recipient's name
- ✓ Recipient's bank name
- ✓ Recipients' account number
- ✓ IFSC code of the beneficiary bank

2. The RTGS Way:- You can transfer money from one bank to another on a real-time basis using Real Time Gross Settlement or RTGS method. There is no maximum transfer limit, but the minimum is Rs. 2 lakhs. The transactions are processed throughout the RTGS business hours. Usually, the amount is remitted within 30-minutes.

To be able to transfer money through RTGS, it is required for the sender and the receiver bank branch to be RTGS enabled. You can find the list of RTGS authorized banks on the RBI website.

Cost Factor- It costs a little more than NEFT. But still, it will not cost you more than Rs. 30 for transactions up to Rs. 5 lakhs. The fee varies from one bank to another.

Requirements-

- ✓ Amount to be sent
- ✓ Account number of the remitter or sender
- ✓ Name of the recipient or beneficiary
- ✓ Account number of the beneficiary
- ✓ Beneficiary's bank and branch name
- ✓ IFSC code of the receiving branch
- ✓ Sender to receiver information, if any

3. IMPS or Immediate Payment Service:- For instant payments, send money through IMPS. The money is transferred instantaneously through mobile phones using this interbank electronic fund transfer service.

You can make the transactions 24X7X365 across banks including all weekends and bank holidays. The money can be transferred using phones, ATMs, Mobile Money Identifier (MMID) and internet banking. The idea is simple – to allow users to make payments with the mobile number of the beneficiary.

Requirements -

- ✓ MMID of the Recipient
- ✓ 7 Digit MMID Number
- ✓ MMID of the receiver
- ✓ Name of the beneficiary
- ✓ Beneficiary's mobile number
- ✓ Account Number of the recipient
- ✓ IFSC Codes of the beneficiary bank

4. Unified Payments Interface (UPI):- UPI-enabled apps allow you to make transactions (up to Rs 1 lakh) with any Smartphone using a VPA (Virtual Payment Address). The steps are

comparatively fewer and the apps enable users to transfer money in much faster. It doesn't require users to share personal details like credit/debit card number or bank account.

Moreover, it is possible to transfer the funds round the clock; and the transactions are done on a real-time basis.

Cost Factor:- There are no charges attached to using the UPI platform for transferring money from one person to another. Earlier, if a person transferred money to a merchant, about Rs. 15 used to be charged from the merchant, but after demonetization, this fee has been waived-off.

REAL TIME GROSS SETTLEMENT (RTGS)

MEANING OF RTGS

The full form of RTGS is **Real Time Gross Settlement,** it is a money transfer process that is performed in real-time and without delays. RTGS requires Net Payment which implies that activities are carried out at an individual level without delay and not in batch-wise process. RTGS is one of the fastest methods of transferring Interbank funds via online banking in India. Transfer of the funds takes place between the two accounts in 30 minutes. While transferring money using RTGS method the following information is required

- The amount of money which is to be transferred
- Name of recipient and payee
- Name of payee and recipient bank
- Payee/beneficiary bank IFSC code
- Payee/beneficiary bank account number

The RTGS money transfer method is operated by the Indian Reserve Bank and thus it is one of the famous and safe methods of transfer of funds.

Advantages of RTGS

RTGS is a common approach of transfer of funds in India, with a variety of features. The advantages of using RTGS as the procedure for money transfers are:

- Reserve Bank of India maintains the RTGS system, which is a secure and safe method of funding.
- There is no room for lag since activities are carried out on a real-time basis.
- The use of RTGS in India is without geographical boundaries.
- Fund transfer is very convenient and can be done from the office or home.
- It is a safe and secure system for funds transfer.
- RTGS transactions / transfers have no amount cap.
- The system is available on all days when most bank branches are functioning, including Saturdays.

- There is real time transfer of funds to the beneficiary account.
- The remitter need not use a physical cheque or a demand draft.
- The beneficiary need not visit a bank branch for depositing the paper instruments.
- The beneficiary need not be apprehensive about loss / theft of physical instruments or the likelihood of fraudulent encashment thereof.
- Remitter can initiate the remittances from his / her home / place of work using internet banking, if his / her bank offers such service.
- The transaction charges have been capped by RBI.
- The transaction has legal backing
-

RTGS Timing And Limit

RTGS Timing	Monday to Saturday(Leave on 2nd and 4th Saturday) – 8.00 to 4.30 am
RTGS Limit	Minimum 2 lakhs to no upper ceiling limit.

NATIONAL ELECTRONIC FUND TRANSFER (NEFT)

MEANING OF NEFT

The full form of NEFT is the **National Electronic Fund Transfer.** Banking has become an important part of our daily lives. Since the time it became online, a number of our activities have been easy to manage. You don't have to go to the bank and wait in long lines for money transfer like before. You no longer have to fill up cheques, withdrawal forms, and chaplains. NEFT is one of the online money transfer methods which are currently in use.

NEFT is a centralized nationwide payment method owned and controlled by the Reserve Bank of India (RBI). It easily transfers money between banks across India. A bank branch should be NEFT enabled to permit a customer to transfer the funds to another party.

Some of the points to be considered while transferring money through NEFT.

- NEFT transaction timing on weekdays from 9.00 am to 7.00 pm and Saturday 9.00 am to 1.00 pm.
- There is no transaction limit, but Rs.50,000 is per transaction limit.

➢ NATIONAL ELECTRONIC FUND TRANSFER PROCESS

When individual wishes to transfer an amount of money from his bank account to another person's bank account, he may do so through the NEFT process rather than withdrawing the

money and then paying it in cash or by issuing a cheque. NEFT has the primary benefit that it can transfer funds from any branch account to any other bank account at any given venue. The only condition is that both the sender and the recipient branches are NEFT-enabled. On the RBI website, you can check the list of NEFT-enabled bank branches, or call your bank's customer service to confirm the same. The NEFT process also allows for cross-border, one-way movement of funds from India to Nepal under the Indo-Nepal Remittance Facility Scheme.

STEPS TO FOLLOW TO TRANSFER MONEY THROUGH NEFT

The Bank IFSC Code, along with other information such as account holder name, bank account number, bank branch and additional information, is a must for authorizing an NEFT transfer.

- **Step 1-**Use your user ID and password to sign in to your online banking account.
- **Step 2-**Go to NEFT Fund Transfer page.
- **Step 3-** Enter recipient name, bank account number and IFSC code.
- **Step 4**-You should initiate an NEFT transfer once the beneficiary is successfully connected. Enter the amount to be transferred and click the send button.

ADVANTAGES OF NEFT SYSTEM

1) There is no need for the physical presence of any party to perform a transaction.
2) No bank visit is required, as long as an individual is keeping a valid bank account.
3) NEFT is efficient and straightforward. It can be done in less than a minute, and hardly involves any significant formality.
4) Confirmation of a successful transaction can be viewed easily via email notifications and text messages.

DIFFERENCES BETWEEN NEFT AND RTGS

NEFT (National Electronic Funds Transfer)	**RTGS (Real-Time Gross Settlement)**
Through National Electronics Funds Transfer, transactions of any amount can be sent to the recipient's account without any	Large amounts of funds can be used to transfer instantly with Real-Time Gross Settlement. The transaction speed is faster than any other form of online payment.

maximum limit to the funds that can be sent in a day	
The National Electronic Funds Transfer method does not have a minimum transfer limit ceiling.	The minimum amount needed to be transferred has to be of Rs. 2 Lakhs and above for RTGS
The funds transferred through NEFT are processed in 12 batches between 8:00 AM to 6:30 PM on weekdays and between 8:00 AM and 1:00 PM on Saturdays. It is not available on Sundays and bank holidays.	The Reserve Bank of India (RBI) has allocated the following time-slots for Real-Time Gross Settlements settlements: • 9:00 AM – 4:30 PM on weekdays • 9:00 AM – 1:30 PM on Saturdays
The settlement of funds happens on a half-hourly basis	The settlement of funds is instantaneous and happens in real-time
The NEFT mode is used when the transactions are of smaller values.	RTGS is used in high-value transactions.
The National Electronic Funds Transfer system was introduced in November 2005 to replace the Special Electronic Fund Transfer (SEFT) system that was in use at the time.	The Real-Time Gross Settlement system was first implemented in India in March 2004 as a major technology-based electronic funds transfer system across the country.
When NEFT transactions fail or are not processed on time, destination banks are required to return the fund to the originating branch within two hours of completion of the batch in which the transaction was processed	In an event when transactions fail, the money is credited into the sender's account once the money is received back by the remitting bank. The funds are returned to the originating bank within one hour or before the end of the RTGS business day or whichever comes first

CORE BANKING

MEANING OF CORE BANKING

Core banking is normally defined as the business conducted by a banking institution with its retail and small business customers. Many banks treat the retail customers as their core banking customers and have a separate line of business to manage small business. Larger business is handled by the corporate banking division of the institution. Core banking basically is depositing and lending of money.

Now a days, most banks use core banking applications to support their operations where 'CORE' stands for "Centralized Online Real-time Environment". This basically means that all the bank's branches access applications from centralized data centres. It means that the deposits made are reflected immediately on the servers of bank and the customer can withdraw the deposited money from any of the branches of bank throughout the world. These applications now also have the capability to address the needs of corporate customers providing a comprehensive banking solution. Normal core banking functions will include deposit accounts, loans, mortgages and payments. Banks make these services available across multiple channels like ATMs, internet banking and branches.

MAXIMUS mCORE is the cutting-edge browser-based core banking application allows a bank for real-time processing of key financial transactions. It enables Bank Customers to operate their accounts & avail banking services from any branch of the Bank on CBS network, regardless of where he maintains his account.

FEATURES OF CORE BANKING

1. Customer relationship management features including a 360 degree customer view.
2. The ability to originate new products and customers.
3. Banking analytics including risk analysis, profitability analysis and provisions for capital reserve allocation and collateral management.
4. Banking finance including general ledger and reporting.
5. Banking channels such as teller systems, side counter applications, mobile banking and online banking solutions.
6. Best practice workflow process.
7. Content management facilities.
8. Governance and compliance capabilities such as internal controls management and auditing.
9. Security control and audit capabilities.
10. Core banking solutions to help maximize growth, increase productivity and mitigate risk.

ADVANTAGES OF CORE BANKING

1. Limited Professional Manpower to be utilized more effectively.
2. Customer can have anywhere, more convenient and easier banking.
3. ATM, Interest Banking, Mobile Banking, Payment Gateways etc. are available.

4. More strong and economical way of management information system.
5. Reduction in branch manpower.
6. Additional manpower can be available for marketing, recovery and personalized banking.
7. Instant information available for decision support.
8. Quick and accurate implementation of policies.
9. Improved Recovery Process causing reduction on recovery costs, NPA provisions.
10. Innovative, redefined or improved processes i.e. Inter Branch Reconciliation causing reduction in manpower at Head Office.
11. Reduction in software maintenance at branch and Head office.
12. Centralized printing and backup resulting in reduction in capital and revenue expenditure on printing and backup devices and media at branches.
13. Electronic Transactions with other Financial Institutions.
14. Increased speed in working resulting in more business opportunities and reduction in penalties and legal expenses.

DISADVANTAGES OF CORE BANKING

1. Excessive reliance on era
2. Any failure in pc structures can cause whole community to head down
3. If records isn't included nicely and if right care isn't always taken , hackers can advantage get admission to the data.

WHOLESALE BANKING

MEANING OF WHOLESALE BANKING

Wholesale Banking refers to the provisions of banking services offered to the industrial and business entities which are rich in resources and have sound income statements. These institutes are generally the mortgage brokers, corporate houses, multinationals, government agencies, real estate investors, other banks and financial institutions.

FEATURES OF WHOLE SALE BANKING:

- **Large Scale Operations**: Wholesale banking majorly meets the enormous financial requirements of the large scale companies and the government.
- **Low Operational Cost**: The cost of carrying out transactions and other banking operations is quite low due to a limited customer base and few numbers of transactions.
- **High Risk Involved**: The risk level involved in wholesale banking is very high since the failure of the borrower company can lead to the collapse of all the parties associated with it.
- **Control Over Financial Transaction Monitoring and Recovery**: Due to limited customers, it becomes convenient for the banks to monitor the financial transactions and recover the loans and advances.
- **Huge Impact on Non-Performing Asset**: If there is delay or default in the repayment of loans and advances provided under wholesale banking, the non-performing assets of the bank increases.
- **High Cost of Deposit**: The interest rates paid by the banks on the deposits made by the substantial business entities is high.

FUNCTIONS OF WHOLESALE BANKING

Wholesale banking is an entirely different concept and does not serve the purpose of small business or individual clients.

1. Primary Functions: Some of the major services performed by wholesale banks are as follows:

- **Making Advances**: The principal purpose of wholesale banks is to provide loans and advances of high value to the large scale business entities.
- **Accepting Deposits**: These banks also receive deposits from the big companies and provides high interest on the deposited funds.
- **Credit Creation**: The wholesale banks increase the flow of funds in the economy by initiating loans and deposits by the government and large scale companies.

2. Secondary Functions: The banks have some additional responsibilities which are mentioned below:

- **Underwriting**: The wholesale bank raises capital for the projects of large business organizations by issuing debt or equity shares to the investors on behalf of the respective companies.
- **Mergers and Acquisitions**: Through operations like currency conversion, these banks facilitate the merger of two or more companies across the globe and also the acquisition of one business unit by the other organization.
- **Trust and Consultancy Services**: The merchant banks provide various other services like investment advice and trust building to the client companies.
- **Fund Management**: The merchant banks continuously function towards managing and handling of the funds deposited by the clients wisely.

RESPONSE OF WHOLESALE BANKS TO MARKET CONDITIONS

Wholesale banks function in the economy and need to adjust and cope up with the market conditions.

Following are the different adjustments and updations made by the merchant banks in this context

- **Global Expansion**: Wholesale banks expand to the places where the multinational client companies have branches.
- **Wholesale Credit Transformation**: A wholesale bank focus on consistent client's experience, processes, roles and technology used in the credit product and bank's operations.
- **Client On boarding**: The primary concern is enhancing the information, transparency, service speed and experience of the client companies.
- **Data Management**: The banks control and enhance the security, governance and quality of the confidential data.
- **Monetize Mobile Capabilities**: These banks facilitate customers with self-service operations and information related to various products and services through mobile channels.

- **Platform Modernization, Simplification and Migration**: The wholesale banks function to simplify and modernize the business operations, accepting of deposits and providing loans and advances.
- **Relationship Management**: Building up long term relationship with the clients is essential for the merchant banks.

ADVANTAGES OF WHOLESALE BANKING

We can now say that wholesale banking is a suitable option for the companies which need substantial financial assistance from time to time and looking forward to availing the opportunities for growth and development

- **Provides Extra Safety to Depositors**: In wholesale banking, the banks treat the deposited funds with a high level of safety and put the amount in comparatively secured investment opportunities.
- **Low Transaction Fees**: The banks charge the transaction fees at a discounted rate for the customers of wholesale banking.
- **Facilitates Large Trade Transactions**: It supports the high-value transactions of the companies operating on a large scale.
- **Fulfils Huge Working Capital Requirements**: Large business associations require a considerable amount of funds to carry out day to day operations. Thus, wholesale banking accomplishes this need by providing funds for working capital.
- **Lending to Government**: These banks even lend funds to the government of the country for carrying out various long-term projects.
- **Provides Cash Management Solution**: Wholesale banking also facilitates effective cash management, i.e. acquisition and investment of cash into the right opportunity.

DRAWBACKS OF WHOLESALE BANKING

- **High Risk**: As we know that the lump sum transactions take place in wholesale banking, there is a high level of risk involved.

- **Expensive Business Accounts**: Maintaining accounts and records is a costly affair in wholesale banking when compared to traditional bank accounts.
- **High-Interest Rates and Processing Fees**: The borrower company is liable to pay off high interest and processing fees on loans and advances to the banks.
- **Relies on Stability of Location**: When the company deposits a large amount at a single location, i.e. the wholesale bank, there is a risk of loss if the bank faces a situation of downfall.
- **Payment for Unused Services**: In wholesale banking, there is always a complaint that the client companies have to pay even for those services which are not used by them.
- **May Lead to Client's Exploitation**: When the borrowed sum is of high value, there are chances that the borrower company may be exploited by the bank.

MODERN WHOLESALE BANKS ENGAGE IN

1. Wholesale financing:- Wholesale finance refers to financial services conducted between financial services companies and institutions such as banks, insurers, fund managers, and stockbrokers.

2. Underwriting :- Underwriting services are provided by some large financial institutions, such as banks, or insurance or investment houses, whereby they guarantee payment in case of damage or financial

loss and accept the financial risk for liability arising from such guarantee. An underwriting arrangement may be created in a number of situations_including insurance, issue of securities in a public offering, and bank lending, among others. The person or institution that agrees to sell a minimum number of securities of the company for commission is called the **underwriter.**

3. **Market Maker** : It is commonly known as a broker firm that provides purchase and sale options for investors in order to keep the financial markets volatile. A broker firm can also be an individual intermediary/Broker.

4. **Mergers and acquisitions** : Mergers and acquisitions (M&A) are transactions in which the ownership of companies, other business organizations, or their operating units are transferred or consolidated with other entities.

5. Fund management : It refers to systematic approach to the governance and realization of value from the things that a group or entity is responsible for, over their whole life cycles. It may apply both to tangible assets (physical objects such as buildings or equipment) and to intangible assets (such as human capital, intellectual property, goodwill and/or financial assets). Asset management is a systematic process of developing, operating, maintaining, upgrading, and disposing of assets in the most cost-effective**.** Manner (including all costs, risks and performance attributes).

The term is commonly used in the financial sector to describe people and companies who manage investments on behalf of others. Those include, for example, investment managers that manage the assets of a pension fund.

RETAIL BANKING

MEANING OF RETAIL BANKING

Retail banking is a major form of commercial banking but mainly targeted to consumers rather than corporate clients. It is the method of banks' approach to the customers for sale of their products. Retail banking is also known as the **consumer banking**

The products are consumer-oriented like offering a car loan, home loan facility, financial assistance for purchase of consumer durables, etc.

Retail banking is a framework that allows commercial banks to offer banking products and services in one place at virtually any of their branch locations. The retail banking aspect turns commercial banks into a kind of "store" (or retailer) where clients are able to purchase multiple banking products.

For example:

Here's a brief story about Bob's day at his bank XYZ. He arrives at the bank one day to deposit a $2000 paycheck into his account. He decides to deposit $1000 of the paycheck into his existing checking account. The other $1000 he decides to use to open a savings account. Bob sits with a bank representative who explains the various savings account options and helps him with opening an account once he's made a decision.

Additionally, the account representative informs Bob of retirement plans the bank offers as well as educational savings plans for his children. Before he leaves, Bob also takes information on auto loans offered by the bank since he is considering purchasing a new car. While at the bank, Bob was able, in one place, to deposit money, open a savings account and find information relating to banking products he may need in the future.

THE MAIN THREE IMPORTANT FUNCTIONS OF RETAIL BANKING

1) Give Credit

Banks offer credit to their clients for purchasing it also includes mortgages and loans. By doing this banks will increase liquidity in the economy. This will lead to increase employment and create more opportunities.

2) Accept Deposit

Banks are a secure place for those who want to deposit their savings. Banks will give a higher rate of interest to savings accounts, certificates of deposits, and other financial products.

3) Money Management

The retail bank will help to manage money through accounts and cards. It will help to do transactions online at any place.

TYPES OF RETAIL BANKS:

- **Commercial Banks:** Also known as banks in general. However, this category excludes investment banks and financial institutions. They help their clients through various banking services like personal banking, business banking, online banking, financial services, and lending and borrowing.
- **Regional Rural Banks:** RRBs are also known Gramin Banks, which have been established at a regional level in various states of India to cater to low-income groups or people residing in regional areas. These banks offer regular retail banking services and also include loans and mortgages.
- **Private Banks:** These are usually the banks that operate in urban areas and cater to moderate to high level income groups.
- **Post Offices:** In regions where people do not have access to regular banks, the National Postal System offered basic banking services like account opening, savings, recurring deposits, and more. For developing countries, this is a convenient and secure mode of banking in areas where underdeveloped sections of society cannot reach the bank.

ADVANTAGES OF RETAIL BANKING:

1. Retail deposits are stable and constitute core deposits.
2. They are interest insensitive and less bargaining for additional interest.
3. They constitute low cost funds for the banks.
4. Effective customer relationship management with the retail customers built a strong base.
5. Retail banking increases the subsidiary business of the banks.
6. Retail banking results in better yield and improved bottom line for a bank.
7. Retail segment is a good avenue for funds development.
8. Consumer loans are presumed to be of lower risk and NPA perception.
9. Retail banking helps economic revival of the nation through increased production activity.

10. Retail banking improves lifestyle and fulfils aspirations of the people through affordable credit.

11. Innovative product development credit.

12. Retail banking involves minimum marketing efforts in a demand-driven economy.

DISADVANTAGES OF RETAIL BANKING:

Disadvantages of Retail Banking are given below:

1. Designing own and new financial products is very costly and time consuming for the bank.

2. Customers now-a-days prefer net banking to branch banking. The banks that are slow in introducing technology-based products, are finding it difficult to retain the customers who wish to opt for net banking.

3. Customers are attracted towards other financial products like mutual funds etc.

4. Though banks are investing heavily in technology, they are not able to exploit the same to the full extent.

5. A major disadvantage is monitoring and follow up of huge volume of loan accounts inducing banks to spend heavily in human resource department

6. Long term loans like housing loan due to its long repayment term in the absence of proper follow-up, can become NPAs.(non performing assets).

RETAIL BANKING PRODUCTS

Retail banking includes a comprehensive range of financial products such as deposit products, loan products and payment services. The typical products offered in the Indian retail banking segment are:

(I) <u>Retail deposit products</u>

1. Saving bank account:

A savings account is a deposit account held at a retail bank that pays interest but cannot be used directly as money in the narrow sense of a medium of exchange. These accounts let customers set aside a portion of their liquid assets while earning a monetary return.

A ***savings account*** is a basic type of ***bank account*** that allows you to deposit money and keep it safe, and withdraw funds, all while earning interest.

Interest rates are relatively low, with the average account paying less than 1 percent annually as of late 2018.

2. Recurring deposit account

A recurring deposit is a special kind of term deposit offered by banks in India which help people with regular incomes to deposit a fixed amount every month into their recurring deposit account and earn interest at the rate applicable to fixed deposits.

RD Interest Rates in India Jul 2019

Interest Rate	5.75% to 8.05%

- Post office recurring deposit can be opened with minimum amount of Rs. 10.
- Check and compare best RD rates online
- Expense of up to Rs. 1 lakh incurred on critical illness has been exempted from tax under Section 80 DDB. Earlier the exemption was Rs. 60,000 for senior citizens and Rs. 80,000 for very senior citizens.
- Tax exempted interest income on deposits with banks has been increased from Rs. 10,000 to Rs. 50,000. Further, TDS will not be required to be deducted under section 194A and it has been extended to all FD and RD schemes.

3. Current deposit account:- Current bank accounts are very popular among companies, firms, public enterprises, businessmen who generally have higher number of regular transactions with the bank. The current account includes deposits, withdrawals, and contra transactions. Such accounts are also called the Demand Deposit Account.

A Current account can be opened in most of the commercial banks. A current account is generally associated with huge transactions on a regular basis. Because of the fluidity that these accounts offer, they don't earn any interest. These also usually do not carry a limit on the number of transactions which can be made

4. **Term deposit account :-** A time deposit or term deposit is an interest-bearing bank deposit with a specified period of maturity. It is a money deposit at a banking institution that cannot be withdrawn for a specific term or period of time. When the term is over, it can be either withdrawn or held for another term.

5. No-frills account or Basic Savings Bank Deposit :- In an attempt at financial inclusion, the RBI launched the "No Frills" account in 2005**. The No Frills account aimed to offer the most basic banking service to those from the low-income backgrounds**. A no-frills account is a bank account that can be opened and maintained with a zero balance, levies zero or nominal charges and does away with the unnecessary services or frills.

RBI replaced the title of the account to Basic Savings Deposit Account (BSDA) in 2012. Therefore, the No Frills account and the Basic Savings Deposit Account are essentially the same thing.

- The No Frills account aimed to offer the most basic banking service to those from the low-income backgrounds.
- Balance in this Account at any point should not exceed Rs 50000/
- An upper monetary limit to the withdrawals made in a particular month i.e Rs. 10,000
- A maximum of 4 withdrawals in a particular month

In case the account doesn't satisfy these conditions, the bank can convert it to a Regular Savings Account as well the downside of such an account is that most of the facilities offered are limited. Once this limit is exceeded, the bank charges for these services

6. Senior citizen deposit account:- Senior Citizens Savings Scheme (SCSS) is a government-backed **savings** instrument offered to Indian residents aged over 60 years. The **deposit** matures after 5 years from the date of **account** opening but can be extended once by an additional 3 years. The SCSS interest rate for January to March 2019 has been set at 8.7%.

7. Traveler's Cheque :- A **traveler's Cheque** is a medium of exchange that can be used in place of hard currency. They can be denominated in one of a number of major world currencies

and are preprinted, fixed-amount cheques designed to allow the person signing it to make an unconditional payment to someone else as a result of having paid the issuer for that privilege.

They were generally used by people on vacation in foreign countries instead of cash, as many businesses used to accept traveler's cheques as currency.

Protect your travel money. ***Travelers Cheques*** may be refunded if lost or stolen.*. ***Travelers Cheques*** are only available for purchase in selected countries

8. Debit card:- A debit card is also known as the bank card or check card. It is a plastic payment card that can be used instead of cash when making purchases**.** It eliminates the need to carry cash or physical checks to make purchases.

9. Credit card:- Just like debit cards, this is a plastic card to make payments instead of cash. Banks allow cardholders to make the payments on credit with a promise to pay the bank the amount spent and agreed on additional charges. In other words, a credit card is a payment card which is issued to the account holders who pay for their goods and services. In credit, if there is no balance in the account then also an account holder can transact and pay money to the merchant. In credit card,
An account holder will get a line of credit from the bank.

2. Retail loan products

- Home loans to resident Indians for purchase of land and construction of residential house/ purchase of ready built house/ for repairs and renovation of an existing house.
- Home loans to Non-Resident Indians.
- Auto loans for new/ used four-wheelers and two- wheelers
- Consumer loans for purchase of jewels, for meeting domestic consumption etc.
- Education loans for pursuing higher education both in India and abroad.
- Trade related advances to individuals for setting up business, retail trade etc.
- Crop loan to farmers.

3. Retail services

- **Safe deposit lockers:**

It is a metal **box**, usually housed in a bank vault, that customers can rent in order to keep valuables, legal documents and other prized possessions in a secure location.

- **Depository services**:

Depository services are services in which the securities of investors are kept in an electronic form just as bank keeps all your cash in its account and provides all services related to the transaction of cash, similarly we help you out in performing the service through a **DEMAT** account

- **Bancassurance products**:

Bancassurance is an arrangement between a bank and an insurance company allowing the insurance company to sell its products to the bank's client base. This partnership arrangement can be profitable for both companies.

OPPORTUNITIES FOR RETAIL BANKING

1. Scope for innovation: Under retail banking as banks try to provide all those products and services which are desired by the customers. This segment has more scope of innovation as the bank can modify the product as per the market demand which helps them from not being outdated.

2. Rise in per capita income: **Per capita income** is a measure of the amount of money earned **per** person in a nation or geographic region. **Per capita income** can be used to determine the **average per**-person **income** for an area and to evaluate the standard of living and quality of life of the population.

There has been increase in the per capita income over the past few years & is expected to grow in the future also. Moreover, the younger population is more comfortable in taking personal debt than previous generations. Their purchasing power has also increased due to economic growth & more jobs. Also GDP of India is expected to grow at a very good rate because of the formation of government by a majority rather than the previous government coalition.

3. Growing economy: Retail banking has enormous opportunities in a growing economy like India. A.T. Kearney, a global mgt. Consulting firm identified India as the '2nd most attractive retail destination' among the 30 emergent markets.

NARROW BANKING

INTRODUCTION OF NARROW BANKING

Narrow banking means a bank which opened only one (or) two branches will take permission from RBI to take deposits from public and it will not give the loans for tenure of 3 months & 4 months because giving short term loans is very risky. Those Banks doing narrow banking will keep the deposit money with government in Government securities for getting interest.

HISTORY OF NARROW BANKING

George Pennacchi discusses narrow banking in an article in the Annual Review of Financial Economics. During the nineteenth century, US banks were more narrow than they are today, and the narrowest (e.g., those under the Louisiana Banking Act of 1842) appeared resistant to panics. Common modern-banking practices, such as maturity transformation and explicit loan commitments, arose only after the creation of the Federal Reserve and the FDIC.

There appears to be little or no benefits available from traditional banks that could not be obtained in a carefully designed narrow bank financial system. Most importantly, a narrow-banking system could have huge advantages in containing moral hazard and reducing the overall risk and required regulation of the financial system.

In contrast, the reaction by US regulators to the recent financial crisis was to expand the government's safety net by raising deposit insurance limits and by giving more financial firms access to insured deposits. Expanding, rather than narrowing, the activities that are funded with insured deposits is justified if one believes that regulation can contain moral hazard when firms have many, complex risk-taking opportunities. Unfortunately, this belief appears dubious if one recognizes that regulators face political and information constraints.

MEANING OF NARROW BANKING

The term "narrow banking" was coined in Litan (1987). Narrow banking is one which is more interested in utilising the funds received by means of deposits in investing government securities rather than using for lending purposes.

The income will be very low since they do not reasonable return by means of investment in securities.

They need not struggle hard to recover the amount lent to the borrowers.

Since the income level is very low, their profit margin will be very thin compared to normal commercial banks.

OBJECTIVES OF NARROW BANKING

1. To free taxpayers from the repeated burden of having to bailout failing banks using taxpayer money.

2. To prevent banks from creating money. Bank money creation has been shown to amplify business cycles.

3. To prevent banks from bundling risk with deposits.

4. Letting depositors (not banks) make the decision whether to risk a depositor's money. Depositors should know better what degrees of risk are appropriate for them (if any).

5. Reducing banks' incentives to take excessive risks with depositors' money, thereby

6. Reducing the implicit subsidies (rescue guarantees) provided to commercial banks by the taxpayer and central banks.

ISSUES OF NARROW BANKING

The narrow (full-reserve) banking proposal calls for a total separation of bank deposit accounts from all other bank activities to address the following issues:

1. During the years leading to financial crises, banks lend around 90% of the money deposited in transaction accounts (such as checking) and over 95% of total deposits (savings accounts included).

2. Banks are not required to obtain permission from depositors to lend and take risks with *their* money.

3. Under this proposal, banks would be able to lend using depositors' money only after the depositors themselves choose to transfer their money to designated "lending" accounts that will be regarded as "risky" accounts (similar to mutual funds).

4. Otherwise, depositors' money will be kept as liquid cash or deposited with the central bank.

OFFSHORE BANKING

ORIGINS OF OFFSHORE BANKING

The term offshore bank originated with banks that were established on the British Channel Islands, off the coast of northwest France. These institutions were set up as tax havens to attract more investment. Currently, many jurisdictions where offshore banks are located do not tax deposits. Offshore banking is also known as & private banking.

MEANING OF OFFSHORE BANKING

The term offshore refers to a location outside of one's national boundaries, whether or not that location is land-based or water-based. The term may be used to describe foreign banks, corporations, investments, and deposits.

A company may legitimately move offshore for the purpose of tax avoidance or to enjoy relaxed regulations. Offshore financial institutions can also be used for illicit purposes such as money laundering and tax evasion.

An offshore bank is a bank located outside the country of residence of the depositor, typically in a low tax jurisdiction (or tax haven) that provides financial and legal advantages.

These advantages typically include:-

a) Greater privacy.
b) Low or no taxation (i.e. Tax havens).
c) Easy access to deposits (at least in terms of regulation).

d) Protection against local, political, or financial instability.

Offshore banking has often been associated with the underground economy and organized crime, via tax evasion and money laundering.

However, legally, offshore banking does not prevent assets from being subject to personal income tax on interest.

Beginning of offshore banking in India was by permitting for the first time OBUs to be set up in SEZs.

Locations of Offshore Banks

Offshore banks are found widely dispersed geographically in being located in places such as the **Cayman Islands, Bermuda, Luxembourg, the Channel Islands, Macau and Panama.** Offshore banks are also located in other places all over the world. Many of them are subsidiaries of larger institutions. Each of these jurisdictions has different laws with regard to account privacy and tax liabilities. They also have different political systems and not all are tax havens.

OBJECTIVES OF OFFSHORE BANKING

1. To identify and analyze the factors that contributes to the growth of offshore banking.

2. To devise the strategy for sustainable development of SEZ through offshore banking.

ADVANTAGES OF OFFSHORE BANKING

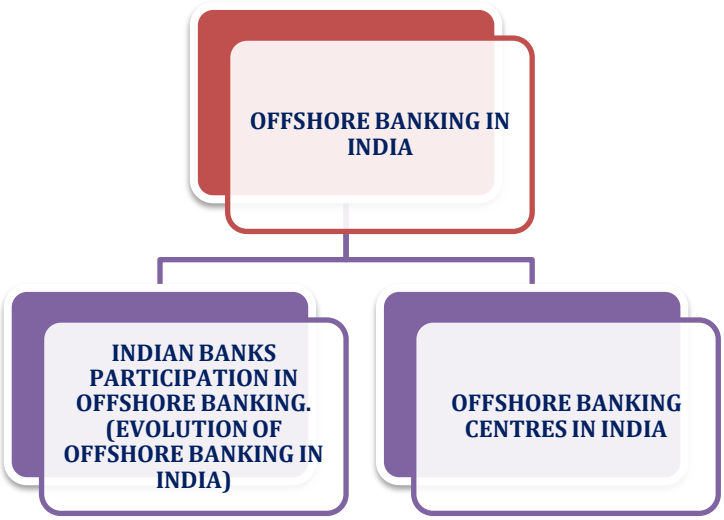
1. Offshore banks can sometimes provide access to **politically and economically stable jurisdictions**. This will be an advantage for residents in areas where there is a risk of political turmoil, who fear their assets may be frozen, seized or disappear.

2. Some offshore banks may operate with a **lower cost base** and can provide higher interest rates than the legal rate in the home country due to lower overheads and a lack of government intervention.
3. Interest is generally paid by **offshore banks without tax being deducted.** This is an advantage to individuals who do not pay tax on worldwide income, or who do not pay tax until the tax return is agreed, or who feel that they can illegally evade tax by hiding the interest income.
4. Some offshore banks offer **banking services that may not be available from domestic banks** such as anonymous bank accounts, higher or lower rate loans based on risk and investment opportunities not available elsewhere.

DISADVANTAGES OF OFFSHORE BANKING

1. Offshore bank accounts are sometimes **less financially secured.** In a banking crisis which swept the world in 2008, some savers lost funds that were not insured by the country in which they were deposited. Those who had deposited with the same banks onshore received all of their money back. Thus, banking offshore is historically riskier than banking onshore.
2. Offshore banking has been **associated in the past** with the underground economy and organized crime, through money laundering. Following September 11, 2001, offshore banks and tax havens, along with clearing houses, have been accused of helping various organized crime gangs, terrorist groups, and other state or non-state actors. However, offshore banking is a legitimate financial exercise undertaken by many expatriate and international workers.
3. Offshore jurisdictions are often remote, and therefore costly to visit, so physical access and access to information can be difficult.
4. Encourage shady dealing and financial crimes due to lax policies.

OFFSHORE BANKING IN INDIA



1. Evolution of Offshore Banking in India

The Sodhani Committee on Foreign Exchange Reforms (1996) has recommended offshore banking in India.

The establishment of offshore centers in India was foreseen when the Foreign Exchange Regulation Act (FERA) was replaced by the Foreign Exchange Management Act, 1999 (FEMA). Article 10 of FEMA included offshore banking units as one of the authorities to whom the RBI could delegate powers for dealing in foreign exchange.

- **Participation of the Indian Banks**

1. State Bank of India
2. India Overseas Bank
3. Bank Of India
4. Bank of Baroda
5. ICICI Bank

2. OFFSHORE BANKING CENTRES IN INDIA

1. Exporters would benefit in terms of finer margins on loans and better foreign exchange rates available via an offshore banking unit.
2. The benefits of multi-currency operations which, to an extent, minimize currency fluctuation risk.
3. Salaries paid by offshore banks and local expenditure incurred by them contribute to the economy's welfare.
4. India may earn revenue in the form of license fees, profit taxes imposed on the banks operating in the area.

5. Benefit of banks' funds in the form of capital & liquidity requirements.
6. The country can gain improved access to the international capital markets.
7. The domestic financial system may become more efficient through increased competition and exposure of the domestic banks to the practices of offshore banks.
8. The offshore banking centres will provide opportunities to train the local staff which will, in turn, contribute to faster economic growth.
9. The offshore banking units would help channelize non- resident Indian investments.
10. Setting up offshore banking centres would trigger enforced development of more advanced communication facilities.

ASSETS IN BANKING

MEANING OF ASSETS BANKING

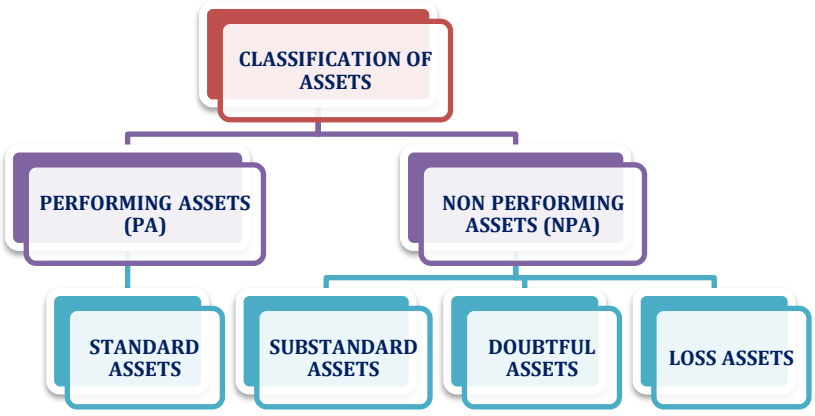
Assets are the ones which are useful or valuable things a person/organization has like goods, property, vehicles, equipment, machinery etc.

If we talk about banks assets:- They are those which the bank has and can be readily converted to cash whenever bank requires money.

The Bank's Assets are:-

1. **Physical Assets -** This includes land, furniture, building etc owned by bank. They are the minor assets.
2. **Cash Present with bank –** Cash which is used for day to day transaction such as for cash withdrawals and cheque processing.
3. **The Interest Amount on Loans –** It is a major asset of a bank because they earn more money by interest amounts of loans than they have to give on saving accounts.
4. **Investments –** This include investments in government securities and other securities, treasury bills etc.

CLASSIFICATION OF ASSET



I. PERFORMING ASSET:- An account does not disclose any problems and carry more than normal risk attached to the business. All loan facilities which are regular!

1. **Standard Assets:-** It carries not more than the normal risk attached to the Business and is not an NPA. Standard assets are the ones in which the bank is receiving interest as well as the principal amount of the loan regularly from the customer. Here it is also very important that in this case the arrears of interest and the principal amount of loan does not exceed 90 days at the end of financial year. If asset fails to be in category of standard asset that is amount due more than 90days then it is NPA and NPAs are further need to classify in sub categories.

II. NON-PERFORMING ASSET:- A non performing asset (NPA) is a loan or advance for which the principal or interest payment remained overdue for a period of 90 days.

Banks are required to classify NPAs further into Substandard, Doubtful and Loss assets.

1. **Sub-standard Asset:-** A sub-standard asset is one which has remained NPA for a period less than or equal to 12months from 31.3.2005. In such case the current net worth of the borrower/guarantor or the current market value of the security charged is not enough to ensure recovery of the dues to the banks in full. In other words, such an asset will have well defined credit weaknesses that jeopardize the liquidation of the debt and are characterized by the distinct possibility that the banks will sustain some loss, if deficiencies are not corrected.

2. **Doubtful Assets:-** With effect from 31.3.2005, an asset is to be classified as doubtful, if it has remained NPA for a period exceeding 12 months. A loan classified as doubtful has all the weaknesses inherent in assets that were classified as sub-standard, with the added characteristics that the weaknesses make collection or liquidation in full, - on the basis of currently known facts, conditions and values- highly questionable and improbable.
   Under this category there are three stages:-
   - D-I Doubtful up to one year
   - D-II Doubtful for further two years
   - D-III Doubtful beyond three years.

3. **Loss Assets:-** An asset identified by the bank or internal/ external auditors or RBI inspection as loss asset, but the amount has not yet been written off wholly or partly. The banking industry has significant market inefficiencies caused by the large amounts of Non Performing Assets (NPA) in bank portfolios, accumulated Over several years. Discussions on non-performing assets have been going on for several years now. One of the earliest writings on NPA defined them as "assets which cannot be recycled or disposed off immediately, and which do not yield returns to the bank, **examples of which are:-** Overdue and stagnant accounts, suit filed accounts, suspense accounts and miscellaneous assets, cash and bank
   balances with other banks, and amounts locked up in frauds".

WHY ASSET MANAGEMENT IS IMPORTANT?

Asset Management is important because it can help organisations to:-

1. Reduce the total costs of operating their assets.
2. Reduce the capital costs of investing in the asset base.

3. Improve the operating performance of their assets (reduce failure rates, increase availability, etc).
4. Reduce the potential health impacts of operating the assets.
5. Reduce the safety risks of operating the assets.
6. Minimise the environmental impact of operating the assets.
7. Maintain and improve the reputation of the organisation.
8. Improve the regulatory performance of the organisation.
9. Reduce legal risks associated with operating assets.

 # Table of ASSETs

Current Asset	**Fixed Asset**	**Tangible Asset**	**Intangible Asset**	**Operating Asset**	**Non-operating Asset**
Cash	Land	Land	Goodwill	Cash	Goodwill
Bank Balance	Road	Road	Patents	Bank Balance	Patents
Investments	Building	Building	Brand	Inventory	
Inventory	Furniture	Furniture	Trademark	Stocks	
Stock	Plant	Plant	Copyright	Prepaid Expense	
Receivables	Machinery	Machinery		Receivables	
Prepaid Expense	Equipment	Equipment		Plant	
Bills Receivable		Cash		Machinery	
		Inventory/ Stock			

RBI GUIDELINES ON INTERNET BANKING

RBI Guidelines on Internet Banking

Reserve Bank of India had set up a 'Working Group on Internet Banking' to examine different aspects of Internet Banking (I-banking). The Group had focused on three major areas of I-banking, i.e, **(i) Technology And Security Issues, (ii) Legal Issues and (iii) Regulatory And Supervisory Issues.** A copy of the Group's report is enclosed. RBI has accepted the recommendations of the Group to be implemented in a phased manner. Accordingly, the following guidelines are issued for implementation by banks. Banks are also advised that they may be guided by the original report, for a detailed guidance on different issues.

I. Technology and Security Standards:-

1. Banks should designate a network and database administrator with clearly defined roles as indicated in the Group's report. (Para 6.2.4)

2. Banks should have a security policy duly approved by the Board of Directors. There should be a segregation of duty of Security Officer / Group dealing exclusively with information systems security and Information Technology Division which actually implements the computer systems. Further, Information Systems Auditor will audit the information systems. (Para 6.3.10, 6.4.1)

3. Banks should introduce logical access controls to data, systems, application software, utilities, telecommunication lines, libraries, system software, etc. Logical access control techniques may include user-ids, passwords, smart cards or other biometric technologies. (Para 6.4.2)

4. At the minimum, banks should use the proxy server type of firewall so that there is no direct connection between the Internet and the bank's system. It facilitates a high level of control and in-depth monitoring using logging and auditing tools. For sensitive systems, a state full inspection firewall is recommended which thoroughly inspects all packets of information, and past and present transactions are compared. These generally include a real time security alert. (Para 6.4.3)

5. All the systems supporting dial up services through modem on the same LAN as the application server should be isolated to prevent intrusions into the network as this may bypass the proxy server. (Para 6.4.4)

6. PKI (Public Key Infrastructure) is the most favored technology for secure Internet banking services. However, as it is not yet commonly available, banks should use the following alternative system during the transition, until the PKI is put in place:-

a) Usage of SSL (Secured Socket Layer), which ensures server authentication and use of client side certificates issued by the banks themselves using a Certificate Server.
b) The use of at least 128-bit SSL for securing browser to web server communications and, in addition, encryption of sensitive data like passwords in transit within the enterprise itself. (Para 6.4.5)

7. It is also recommended that all unnecessary services on the application server such as FTP (File Transfer Protocol), telnet should be disabled. The application server should be isolated from the e-mail server. (Para 6.4.6)

8. All computer accesses, including messages received, should be logged. Security violations (suspected or attempted) should be reported and follow up action taken should be kept in mind while framing future policy. Banks should acquire tools for monitoring systems and the networks against intrusions and attacks. These tools should be used regularly to avoid security breaches. The banks should review their security infrastructure and security policies regularly and optimize them in the light of their own experiences and changing technologies. They should educate their security personnel and also the end-users on a continuous basis. (Para 6.4.7, 6.4.11, 6.4.12)

9. The information security officer and the information system auditor should undertake periodic penetration tests of the system, which should include:-

a) Attempting to guess passwords using password-cracking tools.
b) Search for back door traps in the programs.
c) Attempt to overload the system using DDoS (Distributed Denial of Service) & DoS (Denial of Service) attacks.
d) Check if commonly known holes in the software, especially the browser and the e-mail software exist.
e) The penetration testing may also be carried out by engaging outside experts (often called 'Ethical Hackers'). (Para 6.4.8)

10. Physical access controls should be strictly enforced. Physical security should cover all the information systems and sites where they are housed, both against internal and external threats. (Para 6.4.9)

11. Banks should have proper infrastructure and schedules for backing up data. The backed-up data should be periodically tested to ensure recovery without loss of transactions in a time frame as given out in the bank's security policy. Business continuity should be

ensured by setting up disaster recovery sites. These facilities should also be tested periodically. (Para 6.4.10)

12. All applications of banks should have proper record keeping facilities for legal purposes. It may be necessary to keep all received and sent messages both in encrypted and decrypted form. (Para 6.4.13)

13. Security infrastructure should be properly tested before using the systems and applications for normal operations. Banks should upgrade the systems by installing patches released by developers to remove bugs and loopholes, and upgrade to newer versions which give better security and control. (Para 6.4.15)

II. Legal Issues:-

a) Considering the legal position prevalent, there is an obligation on the part of banks not only to establish the identity but also to make enquiries about integrity and reputation of the prospective customer. Therefore, even though request for opening account can be accepted over Internet, accounts should be opened only after proper introduction and physical verification of the identity of the customer. (Para 7.2.1)

b) From a legal perspective, security procedure adopted by banks for authenticating users needs to be recognized by law as a substitute for signature. In India, the Information Technology Act, 2000, in Section 3(2) provides for a particular technology (viz., the asymmetric crypto system and hash function) as a means of authenticating electronic record. Any other method used by banks for authentication should be recognized as a source of legal risk. (Para 7.3.1)

c) Under the present regime there is an obligation on banks to maintain secrecy and confidentiality of customers'accounts. In the Internet banking scenario, the risk of banks not meeting the above obligation is high on account of several factors. Despite all reasonable precautions, banks may be exposed to enhanced risk of liability to customers on account of breach of secrecy, denial of service etc., because of hacking/ other technological failures. The banks should, therefore, institute adequate risk control measures to manage such risks. (Para 7.5.1-7.5.4)

d) In Internet banking scenario there is very little scope for the banks to act on stop-payment instructions from the customers. Hence, banks should clearly notify to the customers the timeframe and the circumstances in which any stop-payment instructions could be accepted. (Para 7.6.1)

e) The Consumer Protection Act, 1986 defines the rights of consumers in India and is applicable to banking services as well. Currently, the rights and liabilities of customers availing of Internet banking services are being determined by bilateral agreements between the banks and customers. Considering the banking practice and rights enjoyed by customers in traditional banking, banks' liability to the customers on account of unauthorized transfer through hacking, denial of service on account of technological failure etc. needs to be assessed and banks providing Internet banking should insure themselves against such risks. (Para 7.11.1)

III. Regulatory and Supervisory Issues:-

As recommended by the Group, the existing regulatory framework over banks will be extended to Internet banking also. In this regard, it is advised that:-

1) Only such banks which are licensed and supervised in India and have a physical presence in India will be permitted to offer Internet banking products to residents of India. Thus, both banks and virtual banks incorporated outside the country and having no physical presence in India will not, for the present, be permitted to offer Internet banking services to Indian residents.

2) The products should be restricted to account holders only and should not be offered in other jurisdictions.

3) The services should only include local currency products.

4) The 'in-out' scenario where customers in cross border jurisdictions are offered banking services by Indian banks (or branches of foreign banks in India) and the 'out-in' scenario where Indian residents are offered banking services by banks operating in cross-border jurisdictions are generally not permitted and this approach will apply to Internet banking also. The existing exceptions for limited purposes under FEMA i.e. where resident Indians have been permitted to continue to maintain their accounts with overseas banks etc., will, however, be permitted.

5) Overseas branches of Indian banks will be permitted to offer Internet banking services to their overseas customers subject to their satisfying, in addition to the host supervisor, the home supervisor.

Given the regulatory approach as above, banks are advised to follow the following instructions:-

1).

a) All banks, who propose to offer transactional services on the Internet, should obtain prior approval from RBI. Bank's application for such permission should indicate its business plan, analysis of cost and benefit, operational arrangements like technology adopted, business partners, third party service providers and systems and control procedures the bank proposes to adopt for managing risks. The bank should also submit a security policy covering recommendations made in this circular and a certificate from an independent auditor that the minimum requirements prescribed have been met. After the initial approval the banks will be obliged to inform RBI any material changes in the services / products offered by them. (Para 8.4.1, 8.4.2)

b) Banks will report to RBI every breach or failure of security systems and procedure and the latter, at its discretion, may decide to commission special audit / inspection of such banks. (Para 8.4.3)

c) The guidelines issued by RBI on 'Risks and Controls in Computers and Telecommunications' vide circular DBS.CO.ITC.BC. 10/ 31.09.001/ 97-98 dated 4th February 1998 will equally apply to Internet banking. The RBI as supervisor will cover the entire risks associated with electronic banking as a part of its regular inspections of banks. (Para 8.4.4, 8.4.5)

d) Banks should develop outsourcing guidelines to manage risks arising out of third party service providers, such as, disruption in service, defective services and personnel of service providers gaining intimate knowledge of banks' systems and misutilizing the same, etc., effectively. (Para 8.4.7)

e) With the increasing popularity of e-commerce, it has become necessary to set up 'Inter-bank Payment Gateways' for settlement of such transactions. The protocol for

transactions between the customer, the bank and the portal and the framework for setting up of payment gateways as recommended by the Group should be adopted. (Para 8.4.7, 8.4.9.1 – 8.4.9.5)

f) Only institutions who are members of the cheque clearing system in the country will be permitted to participate in Inter-bank payment gateways for Internet payment. Each gateway must nominate a bank as the clearing bank to settle all transactions. Payments effected using credit cards, payments arising out of cross border e-commerce transactions and all intra-bank payments (i.e., transactions involving only one bank) should be excluded for settlement through an inter-bank payment gateway. (Para 8.4.7)

g) Inter-bank payment gateways must have capabilities for both net and gross settlement. All settlement should be intra-day and as far as possible, in real time. (Para 8.4.7)

h) Connectivity between the gateway and the computer system of the member bank should be achieved using a leased line network (not through Internet) with appropriate data encryption standard. All transactions must be authenticated. Once, the regulatory framework is in place, the transactions should be digitally certified by any licensed certifying agency. SSL / 128 bit encryption must be used as minimum level of security. Reserve Bank may get the security of the entire infrastructure both at the payment gateway's end and the participating institutions' end certified prior to making the facility available for customers use. (Para 8.4.7)

i) Bilateral contracts between the payee and payee's bank, the participating banks and service provider and the banks themselves will form the legal basis for such transactions. The rights and obligations of each party must be clearly defined and should be valid in a court of law. (Para 8.4.7)

j) Banks must make mandatory disclosures of risks, responsibilities and liabilities of the customers in doing business through Internet through a disclosure template. The banks should also provide their latest published financial results over the net. (Para 8.4.8)

k) Hyperlinks from banks' websites, often raise the issue of reputational risk. Such links should not mislead the customers into believing that banks sponsor any particular product or any business unrelated to banking. Hyperlinks from a banks' websites should be confined to only those portals with which they have a payment arrangement or sites of their subsidiaries or principals. Hyperlinks to banks' websites from other portals are normally meant for passing on information relating to purchases made by banks' customers in the portal. Banks must follow the minimum recommended security precautions while dealing with request received from other websites, relating to customers' purchases. (Para 8.4.9)

2). The Reserve Bank of India have decided that the Group's recommendations as detailed in this circulars should be adopted by all banks offering Internet banking services, with immediate effect. Even though the recommendations have been made in the context of Internet banking, these are applicable, in general, to all forms of electronic banking and banks offering any form of electronic banking should adopt the same to the extent relevant.

3). All banks offering Internet banking are advised to make a review of their systems in the light of this circular and report to Reserve Bank the types of services offered, extent of their compliance with the recommendations, deviations and their proposal indicating a time frame for compliance. The first such report must reach us within one month from the date of this circular. Banks not offering any kind of I-banking may submit a 'nil' report.

4). Banks who are already offering any kind of transactional service are advised to report, in addition to those mentioned in paragraph above, their business models with projections of cost / benefits etc. and seek our post-facto approval.

5). Please acknowledge receipt.

CHALLENGES FACED BY INDIAN BANKING

#CHALLENGES /PROBLEMS FACED BY INDIAN BANKING

The following points highlight the nine major challenges faced by India's nationalized banks.

Challenge # 1. Losses in Rural Branches:- Most of the rural branches are running at a loss because of high overheads and prevalence of the barter system in most parts of rural India.

Challenge # 2. Large Over-Dues:- The small branches of commercial banks are now faced with a new prob-lem—a large amount of overdue advances to farm-ers. The decision of the former National Front Gov-ernment to waive all loans to farmers up to the value of Rs. 10,000 crores has added to the plight of such banks.

Challenge # 3. Non-Performing Assets:- The commercial banks at present do not have any machinery to ensure that their loans and advances are, in fact, going into productive use in the larger public in-terest. Due to a high proportion of non-performing assets or outstanding due to banks from borrowers they are incurring huge losses. Most of them are also unable to maintain capital adequacy ratio.

Challenge # 4. Advance to Priority Sector:- As far as ad-vances to the priority sectors are concerned, the progress has been slow. This is partly attributable to the fact that the bank officials from top to bot-tom could not accept nationalisation gracefully, viz., and diversion of a certain portion of resources to the top priority and hitherto neglected sectors. This is also attributable to the poor and unsatis-factory loan recovery rates from the agricultural and small sectors.

Challenge # 5. Competition from Non-Banking Financial Institution:- As far as deposit mobilisation is con-cerned, commercial banks have been facing stiff challenges from non-banking financial interme-diaries such as mutual funds, housing finance cor-porations, leasing and investment companies. All these institutions compete closely with commer-cial banks in attracting public deposits and offer higher rates of interest than are paid by commer-cial banks.

Challenge # 6. Competition with Foreign Banks:- Foreign banks and the smaller private sector banks have registered higher increase in deposits. One reason seems to be that non-nationalised banks offer better's customer service. This creates the impression that a diversion of deposits from the nationalised banks to other banks has probably taken place.

Challenge # 7. Gap between Promise and Performance:- One major weakness of the nationalised banking system in India is its failure to sustain the desired credit pattern and fill in credit gaps in different sectors. Even though there has been a reorientation of bank objectives, the bank staff has remained virtually static and the bank procedures and prac-tices have continued to remain old and outmoded.

The post-nationalization period has seen a widen-ing gap between promise and performance. The main reason seems to be the failure of the bank staff to appreciate the new work philosophy and new social objectives.

"Area approach, agricultural development branches, village adoption plans, etc., will be of little avail, if the grass-root level staffs are not im-bued with the motive and the vision of bringing about a silent revolution in the countryside".

Challenge # 8. Bureaucratization:- Another challenge faced by the commercial banks is bureaucratisation of the banking system. This is indeed the result of nationalization. The

smooth functioning of banks has been hampered by red-tapism, long delays, lack of initiative and failure to take quick deci-sions.

Challenge # 9. Political Pressures:- The smooth work-ing of nationalized banks has also been hampered by growing political pressures from the Centre and the States. Nationalized banks often face lots of difficulties due to various political pressures. Such pressures are created in the selection of personnel and grant of loans to particular parties without considering their creditworthiness.

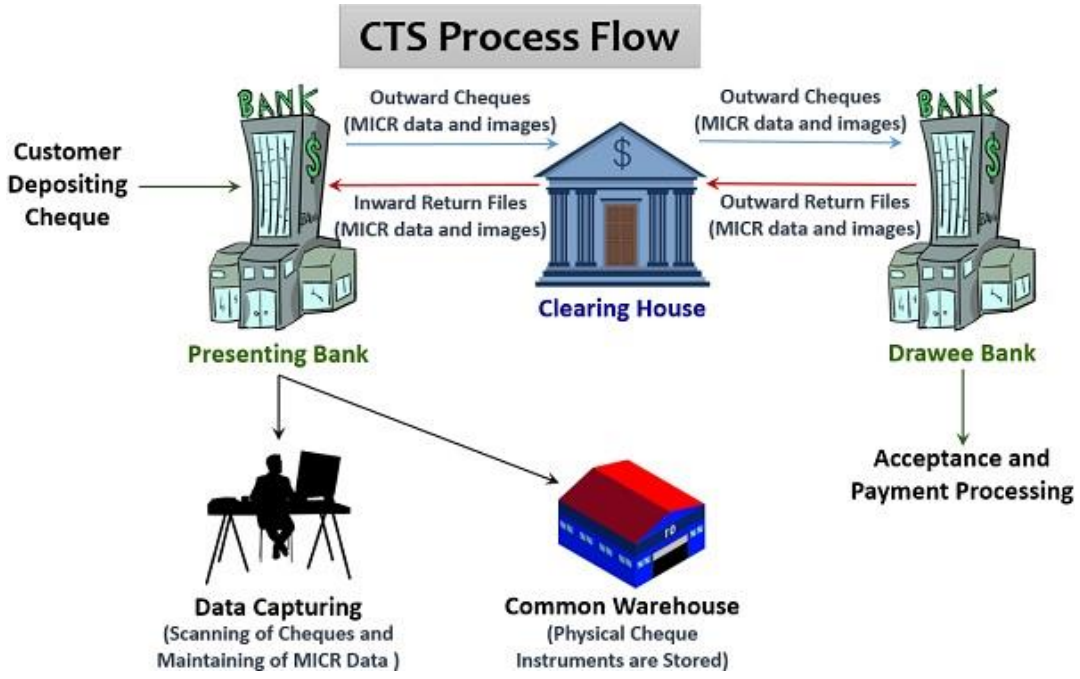
CHEQUE TRUNCATION SYSTEM (CTS)

CHEQUE TRUNCATION SYSTEM (CTS)

Cheque truncation system is an arrangement which facilitates the electronic processing of a cheque with the use of Magnetic Ink Character Reader (MICR) data and the scanned image of the instrument without involving any physical exchange or movement of the financial instrument.

Truncation, as we know, refers to the shortening of the process and therefore, CTS has reduced the time taken in payment processing of a cheque.

To better understand the working of a cheque truncation system, we must go through the following CTS process flow:-



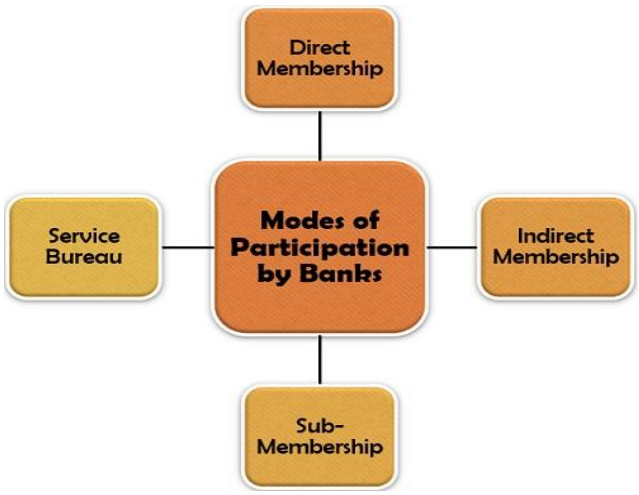
PARTIES INVOLVED IN CTS

To understand how the CTS functions, we must know about the parties involved in it. There are majorly following three parties involved in the cheque truncation system:-

1. **Presenting Bank**: The bank which represents the payee in the whole CTS process is known as the presenting bank. Usually, the presenting bank is that bank where the payee holds an account. We can also say that often the service bank represents the payee in the CTS.
2. **Drawee Bank**: The drawee is the person who is liable to pay, so the drawee bank is that bank which represents the payer and is liable to pay on his/her behalf.
3. **Clearing House**: The Clearing House acts as a link between the above two parties, i.e., the presenting and drawee banks to ensure effortless negotiation of cheque transactions.

MODES OF PARTICIPATION BY BANKS

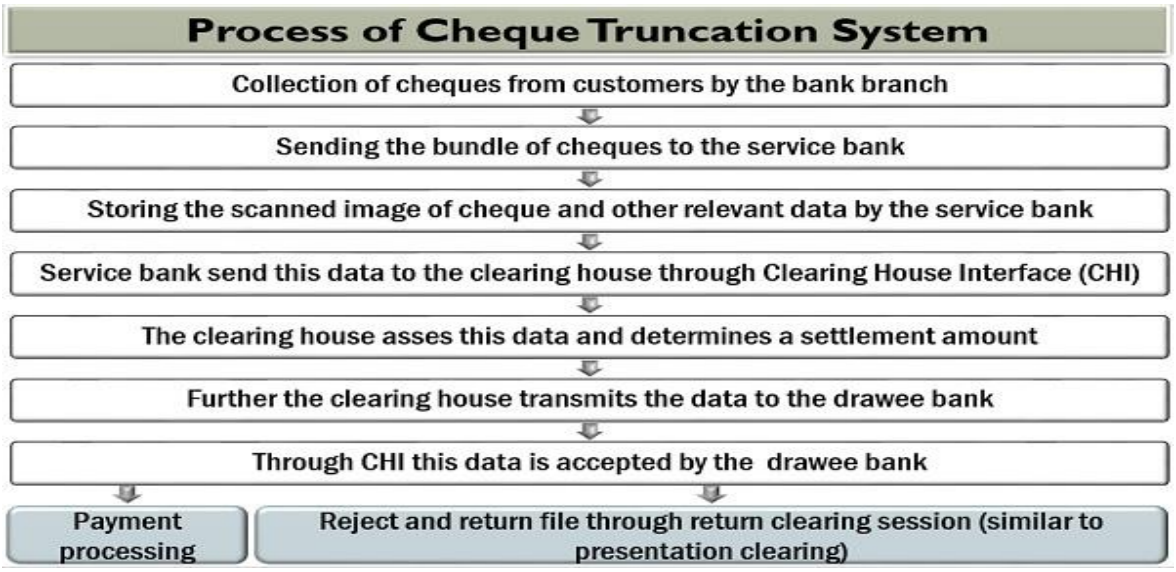
There are four ways in which a bank can participate in the cheque truncation system. These are as follows:-



1) **Direct Membership**: After fulfilling all the conditions essential for participating in the CTS like opening a settlement account with the settlement bank, the banks can become immediate members of the CTS.
2) **Indirect Membership**: To participate indirectly, some banks utilize the CHI infrastructure of the other banks to carry out CTS activities even after having their capture infrastructure.
3) **Sub-Membership**: In sub-membership, the banks can add themselves as sub-members under the direct members of the Clearing House and use their CTS infrastructure.
4) **Service Bureau:** Some banks use the capture infrastructure, set up by the service bureau, i.e. the vendor in collaboration with the third party bank to avail the services of its CHI infrastructure.

PROCESS OF CHEQUE TRUNCATION SYSTEM

Cheque truncation system is a step by step process to simplify the conventional means of cheque clearance. Following is the systematic procedure of CTS:-



In the last step, the drawee bank, after going through the data and image thoroughly can accept the cheque and further proceed with making payment.

Or, it can even reject the data for various reasons like a signature mismatch and incomplete information by returning the file back to the presenting bank through the same process in the reverse order.

Functions of Cheque Truncation System

Following are some of the essential functions performed by the parties involved while carrying out the cheque truncation system:-

1) **Collection of Cheques**: The bank branch initially accepts cheques from its customers and sends these accumulated instruments to their service bank.
2) **Capturing of Data**: At the service bank, the essential information related to the cheque including the cheque no., MICR code, drawee's name, etc. is maintained along with a scanned image of the cheque. This data is then sent to the Clearing House through a secured Clearing House Interface.
3) **Security of Data**: Public Key Infrastructure (PKI) is used to ensure data security. Moreover, while transferring the information and cheque's image to the Clearing House (from where it is sent to the drawee bank), this data is encrypted and duly signed by the presenting bank.
4) **Clearing House Interface**: CHI is a gateway which connects and facilitates the transfer of data between the presenting bank and the drawee bank.

5) **Presentation Clearing**: The Clearing House analyzes the data and determines the settlement amount.
6) **Processing of Payment:** It then forwards the data and image to the drawee bank for payment processing. In case, the cheque is rejected for some reason, the drawee bank returns the data to the Clearing House and then to the presenting bank through return clearing session.
7) **Completion of Cycle:** After the successful execution of the presentation clearing and the return clearing session, i.e. after payment processing or returning of data, the process completes.

ROLE OF MICR IN CHEQUE TRUNCATION SYSTEM

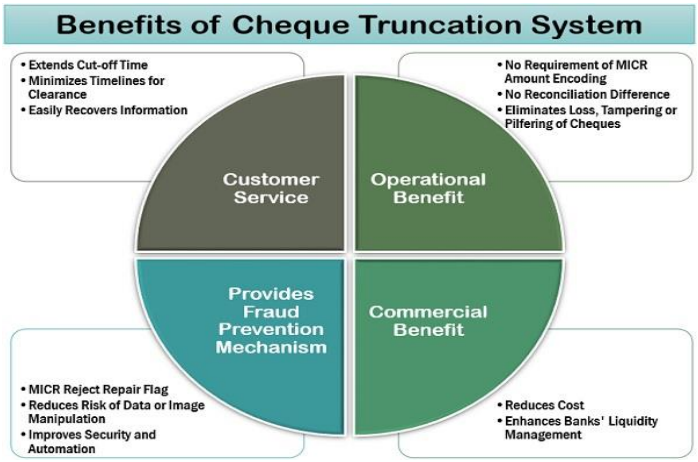
MICR, i.e., Magnetic Ink Character Reader is vastly used in the CTS to identify the data printed on a specified stationary used for a cheque. The MICR has defined a specific guideline which needs to be followed by the banks while designing a cheque instrument.

The cheque must have the following features:

1) Light background colour to highlight the text printed on it.
2) The banks must avoid the use of highly creative or artistic design and tiny letters.
3) Monos, logos or holograms should be on the front and promptly visible.
4) The data generated by the MICR after processing the cheque is exchanged or transferred inward and outward between the parties through the gateway called as the Clearing House Interface.
5) The MICR is capable of automatically mending the data which it detects to be slightly unclear for generating a better output.

BENEFITS OF CHEQUE TRUNCATION SYSTEM

The CTS has multiple advantages to the banks. Moreover, it has modified the conventional cheque clearance process to save the time and efforts of the banking personnel. Following are some of the ways in which CTS benefits the banks:-



1. **Customer Service:-** Customers are the lifeline of any business. Therefore, in the banking industry, also it is essential to enhance their experience. In this context, CTS serves the following purposes:-

a) **Extends Cut-off Time**: The CTS provides a longer cut-off time for the customers to deposit their cheques in their banks.
b) **Minimizes Timelines for Clearance**: Due to CTS, the times taken for cheque clearance have reduced tremendously. Now, the payment of cheques is possible within 24 hours.
c) **Easily Recovers Information**: Since the data is stored in the electronic form, it can be conveniently retrieved whenever required.

2. **Operational Benefit:-** With technological advancement, every industry is becoming quicker; thus CTS too eases out the banking process of cheque processing and payment in the following ways:-

a) **No Requirement of MICR Amount Encoding**:- The banks are not required to encode the cheque amount in the MICR in CTS, thus saving time and efforts.
b) **No Reconciliation Difference**:- The CTS enables prompt and simultaneous processing of the cheques by letting the MICR and image data which removes the reconciliation difference.
c) **Eliminates Loss, Tampering or Pilfering of Cheques**:- When the cheque is transmitted in electronic form instead of physical form, the chances of it being misplaced, forged or stolen eliminates.

3. **Commercial Benefit:-** Everything which is done manually involves a high expenditure of resources on clerical work and stationery. CTS have reduced the burden of banks in the following ways:

a) **Reduces Cost**:- The physical transfer of the paper instruments from one place to another involves specific cost which has been eliminated by the use of CTS.
b) **Enhances Banks' Liquidity Management**:- By implementing grid CTS where the cheques from the different banks are sorted by the Clearing House of a particular grid. Such as CTS Chennai system, which clears the cheques of Mysore and Pondicherry to save cost and manage the liquidity in operations.

4. **Provides Fraud Prevention Mechanism:-** CTS is a quite secured and advanced method of carrying out an automatic cheque clearance process. To avoid fraudulent activities, CTS has the following add-on benefits:

a) **MICR Reject Repair Flag**:- The use of MICR reject repair technology is done under CTR to correct the mistakes and improve the data quality automatically.
b) **Reduces Risk of Data or Image Manipulation**:- The use of encryptions and digital signatures minimizes the risk of any manipulation or forgery.

c) **Improves Security and Automation**:- PKI ensures the security of data throughout the CTS process. The CHI provides for automated transmission of all the data.

Disadvantages of Cheque Truncation System

1. **Costly to Implement:** A successful implementation of Cheque Truncation system in a country involves the participation of all banks. That means, the cost of implementing such a system becomes costly.
2. **Declining Clearing House Payment Mechanism**: Cheque volumes are said to be decreasing at a slow but steady rate, thanks to innovations in technology. Banks are therefore skeptical to invest too much of money in this regard.
3. **New Hardware, Software, Systems, and Processes all add to the complexity of the new system**, making it that more difficult to justify cost against other payment technologies.

RISK INVOLVED IN CHEQUE TRUNCATION SYSTEM

There is a high risk involved in the cheque truncation system. In CTS, cheques are manually scrutinized. This may lead to rejection of a genuine cheque, as a result of being over judgmental or acceptance of fake cheque in carelessness. Even the verification of the signatures may face a similar issue.

LEGAL ISSUES

The Clearing House cannot be blamed for any fraudulent activity or forgery since it is there to facilitate transactions. It majorly functions through the MICR data and acts as a medium for transferring images.

The presenting bank in CTS can verify the credibility of the cheque by analyzing its evident features.

As state under the Negotiable Instruments Act, it is the right of the drawee bank to get a detailed briefing and physical instrument of the cheque for its further verification.

IMPORTANT QUESTION:-

❖ SHORT QUESTIONS (2 MARKS):-

1) Define E- Banking.
2) RTGS
3) NEFT
4) CTS
5) Internet Banking

❖ LONG QUESTIONS (10 MARKS):-

6) Define E-Banking? Disuss its feature, Types , importance & Limitations?

7) Write Detailed noted on Asset of banking?

8) Write the Short notes:-
a) Core Banking
b) Off-shore Banking

9) Discuss the Challenges faced by Indian Banking?

10) Discuss the RBI Guidelines on Internet Banking

11) Write the Short notes:-
a) Universal Banking
b) Narrow Banking

12) Write the Short notes:-
a) Whole Sale Banking
b) Retail Banking

UNIT-IV

➢ INTEREST RATE RISK MANAGEMENT IN BANKS

Interest Rate Risk (IRR)

Interest rate risk is the probability of a decline in the value of an asset resulting from unexpected fluctuations in interest rates. Interest rate risk is mostly associated with fixed-income assets (e.g., bonds) rather than with equity investments. The interest rate is one of the primary drivers of a bond's price.

Definition:– It is the potential loss from unexpected changes in interest rates which can significantly alter a bank's profitability and market value of equity.

The amount at risk is a function of the magnitude and direction of interest rate changes and the size and maturity structure of the mismatch position. If interest rates rise, the cost of funds increases more rapidly than the yield on assets, thereby reducing net income. If the exposure is not managed properly it can erode both the profitability and shareholder value.

➢ TYPES INTEREST RATE RISK MANAGEMENT

1. Repricing risk:- The primary and most discussed form of interest rate risk arises from timing differences in the maturity (for fixed-rate) and repricing (for floating rate) of banking corporation assets, liabilities and OBS positions. Such repricing mismatches may expose a bank's income and economic value to unanticipated fluctuations as interest rates vary.

2. Yield curve risk:- Yield curve risk arises when unanticipated shifts of the yield curve have adverse effects on a banking corporation's income or economic value. The yield curve may shift due to changing relationships between interest rates for different maturities of the same index or market. These changes will be evident in the slope (steeper or flatter) or shape (bend) of the curve.

3. Basis risk:- A risk arising from imperfect correlation in the changes of interest rates in different financial markets or on different instruments with otherwise similar repricing characteristics. Differences in interest rate changes can give rise to unexpected changes in the cash flows and earnings spread between assets, liabilities and OBS instruments of similar maturities or repricing frequencies.

4. Optionality risk:- An additional source of interest rate risk arises from a change in the timing or scope of a financial instrument's cash flows due to changing market interest rates. This risk arises from the options embedded in many banking corporation assets, liabilities and OBS portfolios. These options provide the holder the right, but not the obligation, to buy, sell or in some manner alter the cash flow of the financial instrument. While banking corporations use exchange-traded and OTC options in both trading and no trading accounts, instruments with embedded options are generally more important in non-trading activities.

Examples of instruments with embedded options include various types of bonds and notes with call or put provisions, loans which give borrowers the right to prepay balances, and various types of non-maturity deposit instruments which give depositors the right to withdraw funds at any time, often without penalties.

➢ PRINCIPLES FOR INTEREST RATE RISK MANAGEMENT

1. Board and senior management oversight of interest rate risk

Principle 1: In order to carry out its responsibilities, the board of directors in a bank should approve strategies and policies with respect to interest rate risk management and ensure that senior management takes the steps necessary to monitor and control these risks. The board of directors should be informed regularly of the interest rate risk exposure of the bank in order to assess the monitoring and controlling of such risk.

Principle 2: Senior management must ensure that the structure of the bank's business and the level of interest rate risk it assumes are effectively managed, that appropriate policies

and procedures are established to control and limit these risks, and that resources are available for evaluating and controlling interest rate risk.

Principle 3: Banks should clearly define the individuals and/or committees responsible for managing interest rate risk and should ensure that there is adequate separation of duties in key elements of the risk management process to avoid potential conflicts of interest. Banks should have risk measurement, monitoring and control functions with clearly defined duties that are sufficiently independent from position-taking functions of the bank and which report risk exposures directly to senior management and the board of directors. Larger or more complex banks should have a designated independent unit responsible for the design and administration of the bank's interest rate risk measurement, monitoring and control functions.

2. Adequate risk management policies and procedures

Principle 4: It is essential that banks' interest rate risk policies and procedures are clearly defined and consistent with the nature and complexity of their activities. These policies should be applied on a consolidated basis and, as appropriate, at the level of individual affiliates, especially when recognising legal distinctions and possible obstacles to cash movements among affiliates.

Principle 5: It is important that banks identify the risks inherent in new products and activities and ensure these are subject to adequate procedures and controls before being introduced or undertaken. Major hedging or risk management initiatives should be approved in advance by the board or its appropriate delegated committee.

3. Risk measurement, monitoring and control functions

Principle 6: It is essential that banks have interest rate risk measurement systems that capture all material sources of interest rate risk and that assess the effect of interest rate changes in ways that are consistent with the scope of their activities. The assumptions underlying the system should be clearly understood by risk managers and bank management.

Principle 7: Banks must establish and enforce operating limits and other practices that maintain exposures within levels consistent with their internal policies.

Principle 8: Banks should measure their vulnerability to loss under stressful market conditions - including the breakdown of key assumptions - and consider those results when establishing and reviewing their policies and limits for interest rate risk.

Principle 9: Banks must have adequate information systems for measuring, monitoring, controlling and reporting interest rate exposures. Reports must be provided on a timely basis to the bank's board of directors, senior management and, where appropriate, individual business line managers.

4. **Internal controls**

Principle 10: Banks must have an adequate system of internal controls over their interest rate risk management process. A fundamental component of the internal control system involves regular independent reviews and evaluations of the effectiveness of the system and, where necessary, ensuring that appropriate revisions or enhancements to internal controls are made. The results of such reviews should be available to the relevant supervisory authorities.

5. **Information for supervisory authorities**

Principle 11: Supervisory authorities should obtain from banks sufficient and timely information with which to evaluate their level of interest rate risk. This information should take appropriate account of the range of maturities and currencies in each bank's portfolio, including off-balance sheet items, as well as other relevant factors, such as the distinction between trading and non-trading activities.

6. **Capital adequacy**

Principle 12: Banks must hold capital commensurate with the level of interest rate risk they undertake.

7. **Disclosure of interest rate risk**

Principle 13: Banks should release to the public information on the level of interest rate risk and their policies for its management.

➢ EFFECTS OF INTEREST RATE RISK

1. As the discussion above suggests, changes in interest rates can have adverse effects both on a bank's earnings and its economic value. This has given rise to two separate, but complementary, perspectives for assessing a bank's interest rate risk exposure.

2. Earnings perspective:- In the earnings perspective, the focus of analysis is the impact of changes in interest rates on accrual or reported earnings. This is the traditional approach to interest rate risk assessment taken by many banks. Variation in earnings is an important focal point for interest rate risk analysis because reduced earnings or outright losses can threaten the financial stability of an institution by undermining its capital adequacy and by reducing market confidence.

3. In this regard, the component of earnings that has traditionally received the most attention is net interest income (i.e. the difference between total interest income and total interest expense). This focus reflects both the importance of net interest income in banks' overall earnings and its direct and easily understood link to changes in interest rates. However, as banks have expanded increasingly into activities that generate fee-based and other non-interest income, a broader focus on overall net income - incorporating both interest and non-interest income and expenses - has become more common. The non-

interest income arising from many activities, such as loan servicing and various assets securitization programs can be highly sensitive to market interest rates.

For example, some banks provide the servicing and loan administration function for mortgage loan pools in return for a fee based on the volume of assets it administers. When interest rates fall, the servicing bank may experience a decline in its fee income as the underlying mortgages prepay. In addition, even traditional sources of non-interest income such as transaction processing fees are becoming more interest rate sensitive. This increased sensitivity has led both bank management and supervisors to take a broader view of the potential effects of changes in market interest rates on bank earnings and to factor these broader effects into their estimated earnings under different interest rate environments.

4. Economic value perspective:- Variation in market interest rates can also affect the economic value of a bank's assets, liabilities and OBS positions. Thus, the sensitivity of a bank's economic value to fluctuations in interest rates is a particularly important consideration of shareholders, management and supervisors alike. The economic value of an instrument represents an assessment of the present value of its expected net cash flows, discounted to reflect market rates. By extension, the economic value of a bank can be viewed as the present value of bank's expected net cash flows, defined as the expected cash flows on assets minus the expected cash flows on liabilities plus the expected net cash flows on OBS positions. In this sense, the economic value perspective reflects one view of the sensitivity of the net worth of the bank to fluctuations in interest rates.

5. Since the economic value perspective considers the potential impact of interest rate changes on the present value of all future cash flows, it provides a more comprehensive view of the potential long-term effects of changes in interest rates than is offered by the earnings perspective. This comprehensive view is important since changes in near-term earnings - the typical focus of the earnings perspective - may not provide an accurate indication of the impact of interest rate movements on the bank's overall positions.

6. Embedded losses:- The earnings and economic value perspectives discussed thus far focus on how future changes in interest rates may affect a bank's financial performance. When evaluating the level of interest rate risk it is willing and able to assume, a bank should also consider the impact that past interest rates may have on future performance. In particular, instruments that are not marked to market may already contain embedded gains or losses due to past rate movements. These gains or losses may be reflected over time in the bank's earnings.

For example, a long term fixed rate loan entered into when interest rates were low and refunded more recently with liabilities bearing a higher rate of interest will, over its remaining life, represent a drain on the bank's resources.

- **MEASURING INTEREST RATE RISK**

The techniques available for measuring interest rate risk range from calculations that rely on simple maturity and repricing tables, to static simulations based on current on- and off-balance sheet positions, to highly sophisticated dynamic modelling techniques that incorporate assumptions about the behaviour of the bank and its customers in response to changes in the interest rate environment. Some of these general approaches can be used to measure interest rate risk exposure from both an earnings and an economic value perspective, while others are more typically associated with only one of these two perspectives. In addition, the methods vary in their ability to capture the different forms of interest rate exposure: the simplest methods are intended primarily to capture the risks arising from maturity and repricing mismatches, while the more sophisticated methods can more easily capture the full range of risk exposures.

GAP ANALYSIS: Simple maturity/repricing schedules can be used to generate simple indicators of the interest rate risk sensitivity of both earnings and economic value to changing interest rates. When this approach is used to assess the interest rate risk of current earnings, it is typically referred to as gap analysis. Gap analysis was one of the first methods developed to measure a bank's interest rate risk exposure, and continues to be widely used by banks. To evaluate earnings exposure, interest rate sensitive liabilities in each time band are subtracted from the corresponding interest rate sensitive assets to produce a repricing "gap" for that time band. This gap can be multiplied by an assumed change in interest rates to yield an approximation of the change in net interest income that would result from such an interest rate movement. The size of the interest rate movement used in the analysis can be based on a variety of factors, including historical experience, simulation of potential future interest rate movements, and the judgement of bank management. A negative, or liability-sensitive, gap occurs when liabilities exceed assets (including off-balance sheet positions) in a given time band. This means that an increase in market interest rates could cause a decline in net interest income. Conversely, a positive, or asset-sensitive, gap implies that the bank's net interest income could decline as a result of a decrease in the level of interest rates.

LIMITATIONS OF GAP ANALYSIS: Although gap analysis is a very commonly used approach to assessing interest rate risk exposure, it has a number of shortcomings. First, gap analysis does not take account of variation in the characteristics of different positions within a time band. In particular, all positions within a given time band are assumed to mature or reprice simultaneously, a simplification that is likely to have greater impact on the precision of the estimates as the degree of aggregation within a time band increases. Moreover, gap analysis ignores differences in spreads between interest rates that could arise as the level of market interest rates changes (basis risk). In addition, it does not take into account any changes in the timing of payments that might occur as a result of changes in the interest rate environment. Thus, it fails to account for differences in the sensitivity of income that may arise from option-related positions. For these reasons, gap analysis provides only a rough approximation to the actual change in net interest income which would result from the chosen change in the pattern of interest rates. Finally, most gap analyses fail to capture variability in non-interest revenue and expenses, a potentially important source of risk to current income.

DURATION:-A maturity/repricing schedule can also be used to evaluate the effects of changing interest rates on a bank's economic value by applying sensitivity weights to each time band. Typically, such weights are based on estimates of the duration of the assets and liabilities that fall into each time band. Duration is a measure of the percent change in the economic value of a position that will occur given a small change in the level of interest rates. Duration may also be defined as the weighted average of the time until expected cash flows from a security will be received, relative to the current price of the security. The weights are the present values of each cash flow divided by the current price. In its simplest form, duration measures changes in economic value resulting from a percentage change of interest rates under the simplifying assumptions that changes in value are proportional to changes in the level of interest rates and that the timing of payments is fixed.

CREDIT RISKS IN BANKS

➢ WHAT IS CREDIT RISK IN BANKING?

Credit risk is understood simply as the risk a bank takes while lending out money to borrowers. They might default and fail to repay the dues in time and these results in losses to the bank. Loan portfolio management is very important but most times a bank can't fully assess if it will retrieve the money back because even if the borrowers have been paying their dues on time, the economy might show shift and change the way things have always been. So, what do banks do then? They need to manage their credit risks.

The goal of credit risk management in banks is to maintain credit risk exposure within proper and acceptable parameters. It is the practice of mitigating losses by understanding the adequacy of a bank's capital and loan loss reserves at any given time. For this, banks not only need to manage the entire portfolio but also individual credits.

Credit risk refers to the risk of default or non-payment or non-adherence to contractual obligations by a borrower. The revenue of banks comes primarily from interest on loans and accordingly, loans form a major source of credit risk. Banks face credit risks from financial instruments such as acceptances, interbank transactions, trade financing, foreign exchange transactions, futures, swaps, bonds, options, settlement of transactions, and others.

As of May 2019, credit card losses in the USA outpaced other forms of individual loans. There has been a huge spike in lending to riskier borrowers, which has resulted in larger charge offs by the banks.

➢ CAUSES FOR CREDIT RISK PROBLEMS IN BANKS

Although credit risk is inherent in lending, various measures can be taken to ensure that the risk is minimized. Poor lending practices result in higher credit risk and related losses. The following are some banking practices which result in higher credit risk for the bank:

Cause #1 – Credit Concentration:-Where a majority of the lending of the banks is concentrated on specific borrower/borrowers or specific sectors, it causes a credit concentration. The conventional form of credit concentration includes lending to single borrowers, a group of connected borrowers, a particular sector or industry.

Example #1 – A major bank focuses on lending only to Company A and its group entities. In the event that the group incurs major losses, the bank would also stand to lose a major portion of its lending. Therefore, in order to minimize its risk, the bank should not restrict its lending to a particular group of companies alone.

Example #2 – A bank lends only to borrowers in the real estate sector. In the event that the whole sector faces a slump, the bank would also automatically be at a loss as it will be unable to recover the monies lent. In this scenario, although the lending is not restricted to one company or related group of companies, if all the borrowers are from a specific sector, there still exists a high level of credit risk.

Therefore, in order to ensure that the credit risk is kept at a lower rate, it is important that lending practices are distributed amongst a wide range of borrowers and sectors.

Cause #2 – Credit Issuing Process:-This includes flaws in the banks' credit granting and monitoring processes. Although credit risk is inherent in lending, it can be kept at a minimum with sound credit practices.

The following are instances wherein flaws in the credit processes of the bank results in major credit problems –

#1 – Incomplete Credit Assessment:- In order to evaluate the creditworthiness of any borrower, the bank needs to check for (1) credit history of the borrower, (2) capacity to repay, (3) capital, (4) loan conditions, and (5) collateral. In the absence of any of the above information, the creditworthiness of the borrower cannot be evaluated accurately. In such a case, the bank must exercise caution while lending.

For Example, – Company X wants to borrow $100,000, but it does not furnish sufficient information to perform a thorough credit evaluation. Therefore it is a higher credit risk and will be eligible for a loan only at a higher interest rate as compared to companies that are a lower credit risk. In such a scenario, if a bank agrees to lend money to Company X with a view to earning higher interest, it stands to lose both interests as well as the principal as Company X poses a higher credit risk, and it may default at any stage during repayment.

#2 – Subjective Decision Making:- This is a common practice in many banks and other institutions wherein the senior management is given free rein in making decisions. Where the senior management is allowed to make decisions independent of the company policies,

which are not subject to any approvals, there could be instances where loans are granted to related parties with no credit evaluations being done, and accordingly, the risk of default also increases.

For Example – In the absence of strict guidelines, Mr. K, a director of a major bank, will be more likely to advance loan to a company headed by his relative or close associate without performing adequate credit evaluations. If the loan had been advanced to a third party company with no associations to Mr. K, there would have been a thorough credit check, and the credit risk would be lower. Therefore, it is essential that senior management is not given free rein in lending decisions.

#3 – Inadequate monitoring:-Where the lending is for the long term, they are almost always secured against assets. However, the value of assets may deteriorate over time. Therefore, it is not only important to monitor the performance of the borrowers, but also monitor the value of assets. If there is any deterioration in their value, additional collateral may help reduce credit problems for the bank. Also, another issue could be the instances of fraud relating to collaterals. It is important for banks to verify the existence and value of collaterals prior to lending to minimize the risk of any fraud.

Example A – Company P borrowed $250,000 from a bank against the value of its offices. If the bank regularly monitors the value of the asset, in the event of any diminution in its value, it would be in a position to ask for additional collateral from the Company; however, if there is no regular monitoring mechanism, where both the value of the asset decreases and company P defaults in its loan, the bank stands to lose, which could have been avoided with a sound monitoring practice.

Example B – Let us consider the same example – Company P borrowed $250,000 from a bank against the value of its offices. Prior to lending, it is important that the bank verifies the existence of the asset as well as its value and not go simply by the paperwork submitted. There could be instances of fraud wherein loans are taken against fictitious assets.

Example C – Company P borrows $100,000 with no collateral based on its performance. Performing credit evaluation prior to lending is not sufficient. It is essential that the performance of Company P is regularly monitored by the Bank to ensure that it is in a position to repay the loan. In case of poor performance, the bank may request collateral to be provided and therefore reduce the credit risk impact.

Cause #3 – Cyclical Performances:- Almost all industries go through a depression and a boom period. During the boom period, the evaluations may result in the good creditworthiness of the borrower. However, the cyclical performance of the industry must also be taken into account in order to arrive at the results of credit evaluations more accurately.

Example – Company Z obtains a loan of $500,000 from a bank. It is engaged in the business of the real estate. If it borrows during a period of boom, the bank must also take into account its performance during any subsequent depression. The bank must not always go by current trends but must also provide for any future slumps in the industry performances.

➢ TYPES OF RISKS

1) Credit Default Risk:-The risk of loss which arises from the debtor being unlikely to repay the amount in full or when the debtor is more than 90 days past is the due date of credit payment, it gives rise to credit default risk. The Credit default risk impacts all the sensitive transactions which are based on credit like loans, derivatives or securities. Credit default risk is also checked by banks before approving any credit cards or personal loan.

2) Concentration Risk:-This is the type of credit risk which is associated with exposure of any single or group with the potential to produce large losses to threaten the core operations of a bank. It may arise in the single form of single name concentration even industry concentration.

3) Country Risk:-The risk which arises from a sovereign state when it freezes the payments for foreign currency overnight defaults or its obligation which is termed as sovereign risk. Country risk is exclusively associated with the performance of macroeconomics of a country and is also closely related to the political stability in the country. Sudden instability, which tends to happen during the elections, results in high country risk.

➢ MITIGATION(REDUCE) OF CREDIT RISKS

There are multiple ways to mitigate the credit risk which are as follows:

A) Best Credit Risk-Based Pricing:-The lenders usually charge a higher rate of interest to borrowers who are defaulters. This practice is known as risk-based pricing. The lenders take into consideration the factors such as on purpose credit rating and loan to value ratio.

B) Credit insurance and credit derivatives:-Bondholders hedge the risk by purchasing credit derivatives or credit insurances. These contacts ensure the transference of the risk from the gender to the server against a specific amount of payment. Credit default swap is the most common form of credit derivative used in the market.

C) Best Covenants:-Stipulations may be written by lenders to the borrowers which are called covenants. These are usually written into loan agreements such as a periodic report about the financial condition, refrain from paying dividends or further borrowing of amount or any other specific action that affect the company's financial position in a negative way or repayment of the full loan at the request of the gender in events such as borrower changes or changes in debt to equity ratio or change in interest coverage ratio.

D) Diversification:-Lenders diversify their borrower pools and reduce the risk.

➢ CALCULATING CREDIT RISK

The overall payment ability of the payer is calculated to determine the credit risk. The analysis of calculating risk takes into consideration the revenue generating ability of the borrower along with current assets with the borrower and taxing authority.

Credit risk calculation can be done in the following way:-

A standardized credit score such as FICO (Fair Isaac Corporation) score is determined of the borrower. The FICO score helps in determining the credit history, repayment capacity and creditworthiness of an individual. On one hand, the FICO score indicates the way in which an individual makes the repayment of his debts, it does not ensure repayment in the future.

The next step in calculating credit risk would be to calculate Debt-to-income ratio. This is calculated by monthly recurring debts of a company and divided by gross monthly income. **The individuals who have a score of less than 35% are considered as acceptable credit risk.**

The last step is to factor in the potential loan of the borrower. The potential loan would be the debt which can be taken by the borrower on the basis of his credit cards and other general creditworthiness. This gives a potential of loan and payment capacity of the borrower.

➢ SIX ELEMENTS FOR A SUCCESSFUL CREDIT RISK MANAGEMENT PROCESS

1. Know Your Customer:- Know your customer (KYC) is an integral part of the credit risk management process and forms the basis for all subsequent steps in the lending process. On the one hand, this involves mandatory verification of new and existing customers' credentials to prevent money laundering. On the other, it is also important to collect pertinent, accurate, timely information to establish a solid client relationship so that the bank can position itself as a financial advisor and provider of financial products and services.

2. Analyze Non-financial Risks:- In addition to a creditworthiness assessment, qualitative criteria play an important role in assessing the future of a company. Among the qualitative rating criteria ("soft factors") are non-quantifiable criteria that can have a lasting adverse

effect on company development. Here, the financial institution pays special attention to analyzing success criteria, which are important for the future development of the company.

Factors such as management, competitive situation and market position (local competitors, market share, competitiveness of services, etc.), industry, etc. are assessed qualitatively. These soft factors usually allow the bank to predict future corporate crises with a longer lead time than is possible with quantitative criteria.

3. Understand the Numbers:- Establishing a banking relationship and granting loans is associated with various advantages, but also risks. Lenders should therefore know how and for what the requested funds are used, and how they are expected to be repaid. In addition, all risks associated with the customer should be identified, categorized, and prioritized in the credit risk management process. In order to understand the figures, the focus should be on the company's financial performance – to this end, the company's economic situation is examined. Documents relating to the company's net assets and earnings are analyzed. These documents are generally current annual financial statements, business evaluations or, as necessary, net income statements.

4. Give the Deal A Price Tag:- Setting an appropriate price is one of the key elements of credit risk management. Qualitative and quantitative evaluations form the basis for assessing the risk associated with granting loans to a company. Rating procedures or other valuation models are used to assess risk, which is used, in turn, to calculate the interest rate. A number of complex factors determine the final interest rate. Among the most important are (1) the company's economic situation (creditworthiness) and (2) the collateral provided (value retention of collateral). The principle is: the better the financial situation of the company and the more valuable the collateral provided, the lower the interest rate. The interest rate assigned ensures that the financial institution is adequately compensated for the risk associated with the transaction.

5. Present and Close the Deal:- The well-founded and professional communication of the rating and scoring results and the costs is an important prerequisite for the deal being accepted and concluded. Credit decisions should not be made solely based on credit ratings. This would not be complete without an equal emphasis on qualitative elements such as the competence of management, the competitive, etc. When analysis, structuring, and pricing are completed, there is nothing else in the way of concluding the transaction.

6. Monitor the Business Relationship:-In today's competitive environment, banks cannot afford to wait for repayment of their loans, expecting customers to actively ask for other products and services. In order to maintain its market position, a bank must continue to

monitor the client's risk profile, looking for opportunities to develop and expand the relationship.

A profitable relationship can quickly become an unprofitable one. Even when loan payments remain timely, deterioration of collateral, untapped potential, or unpaid taxes can pose a serious risk to a bank. Periodic reviews, evaluations, and audits can ensure that the client remains profitable for the bank in the long term.

➢ CHALLENGES TO SUCCESSFUL CREDIT RISK MANAGEMENT

1. **Inefficient data management.** An inability to access the right data when it's needed causes problematic delays.
2. **No group wide risk modeling framework.** Without it, banks can't generate complex, meaningful risk measures and get a big picture of group wide risk.
3. **Constant rework.** Analysts can't change model parameters easily, which results in too much duplication of effort and negatively affects a bank's efficiency ratio.
4. **Insufficient risk tools.** Without a robust risk solution, banks can't identify portfolio concentrations or re-grade portfolios often enough to effectively manage risk.
5. **Cumbersome reporting.** Manual, spreadsheet-based reporting processes overburden analysts and IT.

➢ HOW DO BANKS SET UP A CREDIT RISK MANAGEMENT SYSTEM?

Even though every bank may have their own approach to establishing **credit risk management models**, there are a few basic steps that every Credit Risk Management includes-

a) A complete understanding of a bank's own capital reserve. Understanding a bank's overall credit risk based on individual, customer and portfolio levels.
b) Implementing an integrated and quantitative credit risk solution to make an appropriate credit risk environment.
c) The business model in place should be such that is ever-evolving, able to achieve real-time scoring to limit monitoring, have data visualization capabilities and business intelligence tools to make it available any time.

d) Establishing a sound credit-granting process or criteria that will clearly indicate the bank's target market. This should include appropriate credit administration, measurement and monitoring process.

These are some principle ways to set up a Credit Risk Management system that will help in minimizing risk and maximizing reputation and productivity. Often, banks do prefer having a consulting agency to look after their Credit Risk Management since managing credit risk is a tricky task due to a lot of recommendations and predictions, thus there shouldn't be any possibility of loopholes in the process.

➢ ADVANTAGES OF CREDIT RISK

1) It helps in predicting and/ or measuring the risk factor of any transaction.
2) It helps in planning ahead with strategies to tackle a negative outcome.
3) It helps in setting up credit models which can act as a valuable tool to determine the level of risk while lending.

➢ DISADVANTAGES OF CREDIT RISK

1) Prediction is not entirely scientific, so judgment made can go either way.
2) Cost and control of operating a credit scoring system are questionable.
3) While different models may work, there are no guarantees. For this reason, some banks prefer one model

➢ CONCLUSION

Credit Risks in Banks are inherent to the lending function. They cannot be avoided wholly; however, their impact can be minimized with proper evaluation and controls. Banks are more prone to incur higher risks due to their high lending functions. It is important that they identify the causes for major credit problems and implement a sound risk management system so that they maximize their returns while minimizing the risks.

LIQUIDITY RISK MANAGEMENT

➢ WHAT IS LIQUIDITY RISK?

Liquidity risk is the current and future risk arising from a bank's inability to meet its financial obligations when they come due. A bank might lose liquidity if it experiences sudden unexpected cash outflows by way of large deposit withdrawals, large credit disbursements, unexpected market movements or crystallisation of contingent obligations. The other cause may be because of some other event causing counterparties to avoid trading with or lending to the bank. A bank is also exposed to liquidity risk if markets on which it depends are subject to loss of liquidity.

➢ TYPES OF LIQUIDITY RISK

There are three types of liquidity risks:-

1. FUNDING RISK: - It depends on the perception of the market of the credit standing of the bank. A bank approaching the market with unexpected and frequent needs for funds would have adverse effect on the willingness of the market to lend and raises the cost of funds which is the prime driver of profitability.

2. ASSET LIQUIDITY RISK:- It arises when assets are not readily tradable. The rationale of liquidity ratio is to make banks hold more short-term assets than short-term liabilities. Liquidity risk arises when maturities of assets exceed those of liabilities.

3. INTEREST RATE RISK:- Liquidity risk is closely related to interest rate risk. If a bank desires to have more interest sensitive liabilities than assets it reduces the liquidity position of banks. When a bank structure its portfolio in order to achieve a positive duration gap (assets>liabilities), the liquidity of the assets is reduced. If interest rates increases the value of long-duration assets will decline more than short-duration assets and assets sales would involve losses.

➢ LIQUIDITY PROCEDURE:-

Effective liquidity management requires 3 steps:-Identifying liquidity, Managing liquidity, Optimizing liquidity these steps are interdependent, each requiring the successful implementation of the other two to optimally manage liquidity.

1) Identifying liquidity:- It is the foundation on which the entire liquidity management process depends. It involves understanding the balances and positions of the institution on an enterprise-wide level. Identifying liquidity is primarily a function of data gathering, and does not include the actual movement or usage of funds.

2) Managing liquidity:- It involves using the identified liquidity to support the bank's revenue generating activities. This may include consolidating funds, managing the release of funds to maximize their use.

3) Optimizing liquidity:-It is an ongoing process with a focus on maximizing the value of the institution's fund. It requires strong and detail understanding of bank's liquidity position across all currencies, accounts, business lines and counter parties. The biggest challenge in the liquidity management process is the limited and resources available to it.

➢ APPROACHES TO LIQUIDITY RISK MANAGEMENT IN BANKS

Given below are two approaches to liquidity risk management in banks that relate to these two situational decisions:-

1. Fundamental Approach.
2. Technical Approach.

These two methods distinguish from each other in their strategically approach to eliminate liquidity risk. While the fundamental approach aims to ensure the liquidity for long run sustenance of the bank, the technical approach targets the liquidity in the short run. Due to these features, the two approaches supplement each other in eliminating the liquidity risk and ensuring profitability.

1. Fundamental Approach:- Since long run sustenance is driving factor in this approach, the bank tries to tackle /eliminate the liquidity risk in the long run by basically controlling its assets-liability position. A prudent way of tackling this situation can be by adjusting the maturity of assets and liabilities or by diversifying and broadening the sources of funds.

The two alternatives available to control the liquidity exposure under this approach are **Asset Management and Liability Management.** This implies that liquidity can be imparted into the system either by liability creation or by asset liquidation, which eve suite the situation.

I. Asset Management: Asset management is to eliminate liquidity risk by holding near cash assets i.e. those assets, which can be turned into cash whenever required. For instance, sale of securities from the investment portfolio can enhance liquidity. When asset management is resorted to, the liquidity requirements are generally met from primary and secondary reserves. Primary reserves refer to cash assets held to meet the statutory cash reserve requirements (CRR) and other operating purposes. Though primary reserves do not serve the purpose of liquidity management for long period, they can be held as second line of defense against daily demand for cash. This is possible mainly due to the flexibility in the cash reserve balances (statutory cash reserves are required to be maintained only on a daily average basis for a reserve maintenance period). However, most of the liquidity is generally attained from the secondary reserves,

which include those assets held primarily for liquidity purposes. These secondary reserves are highly liquid assets, which when converted into cash carry little risk of loss in their value. Further, they can also be converted into cash prior to their maturity at the discretion of the management. When asset management is resorted to for liquidity, it will be through liquidation of secondary reserves. Assets that fall under this category generally take the form of unsecured marketable securities. The bank can dispose these secondary reserves to honor demands for deposit withdrawals, adverse clearing balances or any other reasons.

II. **Liability Management:** Converse to the asset management strategy is liability management, which focuses on the sources of funds. Here the bank is not maintaining any surplus funds, but tries to achieve the required liquidity by borrowing funds when the need arises. The underlying implications of this process will be that the bank mostly will be investing in long-term securities /loans (since the short-term surplus balance will mostly be in a deficit position) and further, it will not depend on its liquidity position/surplus balance for credit accommodation/business proposals. Thus in liability management a proposal may be passed even when there is no surplus balance since the bank intends to raise the required funds from external sources. Though it involves a greater risk for the bank, it will also fetch higher yields due to the long-term investments. However, sustenance of such high spreads will depend on the cost of borrowing. Thus, the cost and the maturity of the instrument used for borrowing funds play a vital role in liability management. The bank should on the one hand be able to raise funds at low cost and on the other hand ensure that the maturity profile of the instrument does not lead to or enhance the liquidity risk and the interest rate risk. Of the two strategies available in fundamental approach, it is understood that while asset management tries to answer the basic question of how to deploy the surplus to eliminate liquidity risk, liability management tries to achieve the same by mobilizing additional funds.

2. Technical Approach:- As mentioned earlier, technical approach focuses on the liquidity position of the bank in the short run. Liquidity in the short run is primarily linked to the cash flows arising due to the operational transactions. Thus, when technical approach is adopted to eliminate liquidity risk, it is the cash flows position that needs to be tackled. The bank should know its cash requirements and the cash inflows and adjust these two to ensure a safe level for its liquidity position.

Working Funds Approach and the Cash Flows Approach are the two methods to assess the liquidity position in the short run. Of these two approaches, the former concentrates on the actual cash position and depending on the factual data, it forecasts the liquidity requirements. The latter approach goes a step forward and forecasts the cash flows i.e. estimates any change in the deposits withdrawals credit accommodation etc. Thus apart from assessing the liquidity requirements, it also advises the bank on its investments and borrowing requirements well in advance.

➢ CONFLICT IN LIQUIDITY RISK MANAGEMENT

1. Pricing of assets and liabilities determines the short term problems in liquidity management for banks
2. Balancing returns in relation to fund requirements is the core of liquidity management
3. If liabilities are priced less (rate of interest on a deposit in a bank is lower than that of other peer level banks), there will be more outflow, assuming assets (loans and advances, investment) remain at the same level
4. If liabilities are priced low (rate of interest on bank deposit is lower than other banks), the bank will face shortage of inflow, assuming asset demand remains the same
5. An ideal balance is to be maintained between the levels of liabilities and assets so as to avoid the liquidity trap

➢ FOCAL AREAS FOR BANKS IN LIQUIDITY MANAGEMENT

1. Composition of liabilities, particularly the level of demand liabilities (current accounts and saving bank accounts) in relation to term liabilities (fixed deposits)
2. Build-up of assets, particularly the level of term assets (term loans beyond 3 years and investments in long term securities to be held till maturity) in relation to short term assets net of non-performing assets (cash credit, overdrafts, demand loans)
3. Predominant area of operation
4. Dominant customer profile of the bank
5. Ownership of the bank (Government holding, Institutional holding, Public holding)
6. Public image of the bank

OPERATIONAL RISK MANAGEMENT

➢ OPERATIONAL RISK

It is a very broad concept which focuses on the risks arising from the people, systems and processes through which a company operates. It also includes other categories such as:

- fraud risks
- legal risks
- physical or environmental risks

"The risk of loss resulting from inadequate or failed internal processes, people and systems or from external events.

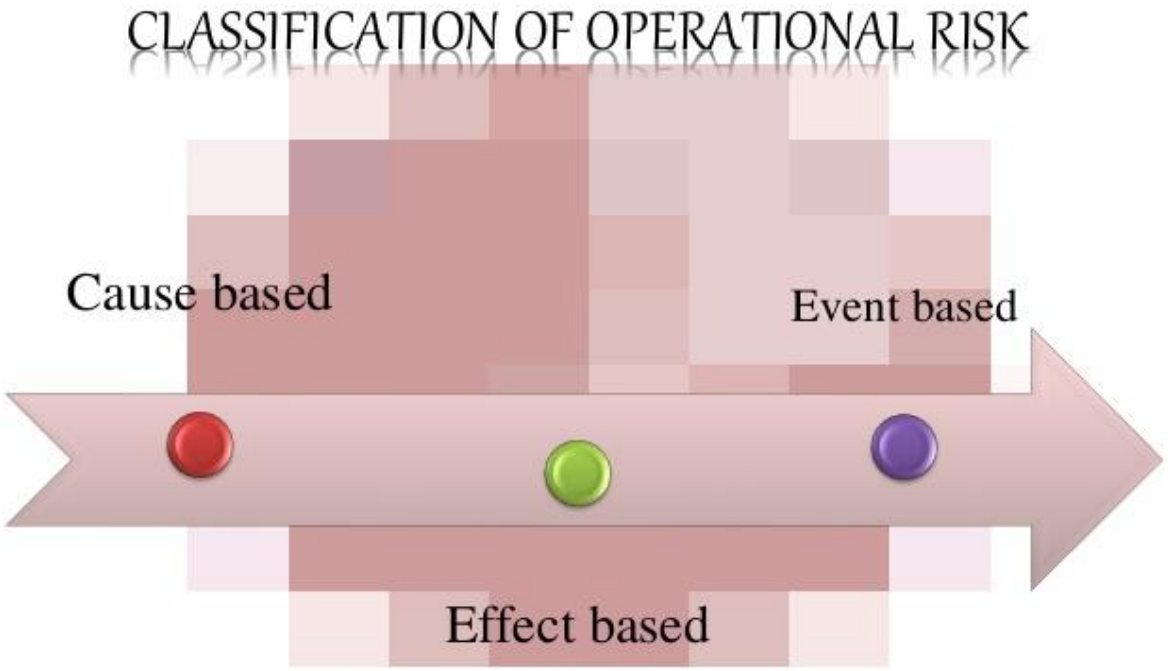
➢ NATURE OF OPERATIONAL RISK

1. OR exists almost everywhere in the organization.
2. OR vary in their components. some are high occurrence low value risks, while some are low occurrence high value risk.
3. OR in the organization continuously change especially when an organization is undergoing changes.

➢ WHO SHOULD MANAGE OPERATIONAL RISK

1) **Board:** responsible for the high level policies
2) **Top management:** responsible for creating a structured control environment and laying down procedures
3) **Middle management**: implement the Risk practices conforming to the above.
4) **Statutory Auditors:** Ascertain if the Internal controls are adequate enough to mitigate the risks.

➢ CLASSIFICATION OF OPERATIONAL RISK



1. CAUSED BASED:- People oriented causes Negligence ,incompetence , insufficient training ,integrity, key man Process oriented (transaction based) causes Business volume fluctuation, organizational complexity , product complexity , and major changes. Process oriented(operational control based) causes Inadequate segregation of duties, lack of management supervision, inadequate procedures. Technology oriented causes Poor technology and telecom , obsolete application, lack of automation, information system complexity, poor design , development and complexity. External causes Natural disasters, operational failures of a third party, deteriorated social or political context.

2. EFFECT BASED Legal liability Regulatory, compliance and taxation penalties Loss or damage to assets Restitution Loss of recourse Write-downs

3. EVENT BASED:- Internal Fraud Misappropriation Of Assets, Tax Evasion, Intentional Mismarking Of Positions, Bribery External Fraud Theft Of Information, Hacking Damage, Third-party Theft And Forgery Employment Practices and Workplace Safety Discrimination, Workers Compensation, Employee Health And Safety Clients, Products, & Business Practice Market Manipulation, Antitrust, Improper Trade, Product Defects, Fiduciary Breaches, Account Churning Damage to Physical Assets Natural Disasters, Terrorism, Vandalism Business Disruption & Systems Failures Utility Disruptions, Software Failures, Hardware Failures Execution, Delivery, & Process Management Data entry errors, accounting errors, failed mandatory reporting, negligent loss of client assets

WHAT ARE THE TOP OPERATIONAL RISKS FOR BANKS?

Operational risk in banking is the risk of loss that stems from inadequate or failed internal systems, internal controls, procedures, or policies due to employee errors, breaches, fraud, or any external event that disrupts a financial institution's processes.

Operational risk, which includes cyber security risk, is one of the most critical risks that financial institutions have to manage and evaluate. In the years since the global financial crisis, the financial services sector has become ever more aware of the need to manage operational risk.

Although financial institutions have established advanced systems to control financial risk, including credit risk, liquidity risk, and market risk, they haven't been able to deal with operational risk effectively.

The top operational risks in banking include:

- **Cyber security risks**: Even as financial institutions ramp up their cyber security efforts, cyber risks, including ransom ware and phishing, have become more frequent and more effective, posing a major risk to financial institutions.

- **Third-party risk**: Increasingly, financial institutions are relying on third-party providers, which means they have to thoroughly identify, evaluate, and control third-party risks

throughout the lifecycle of their relationships with those companies. However, financial institutions also have to identify and evaluate the risks associated with the vendors, suppliers, and contractors that their third-party vendors use.

- **Internal fraud**: Losses from fraud inside a financial institution can stem from misappropriation of assets, forgery, tax non-compliance, bribes, and theft.

- **External fraud**: Fraud committed by third parties includes check fraud, theft, hacking, breaching system security, and data theft.

- **Business disruption and systems failures**: Hardware or software system failures, power failures, and disruption in telecommunications can interrupt the financial institution's business operations and cause financial loss.

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➢ PRINCIPLES OF OPERATIONAL RISK

PRINCIPLE 1:- Board of directors should be aware of the major aspects of banks OR as a distinct risk category that should be managed. And it should approve and periodically review the bank's ORM framework.

PRINCIPLE 2 The board of directors should ensure that the ORM framework is subject to effective and comprehensive internal audit by operationally independent and competent staff

PRINCIPLE 3 Senior management should have responsibility for implementing ORM framework approved by board of directors. They should also have responsibility for developing policies, processes and procedure for managing OR in all of the bank's material products, processes and systems.

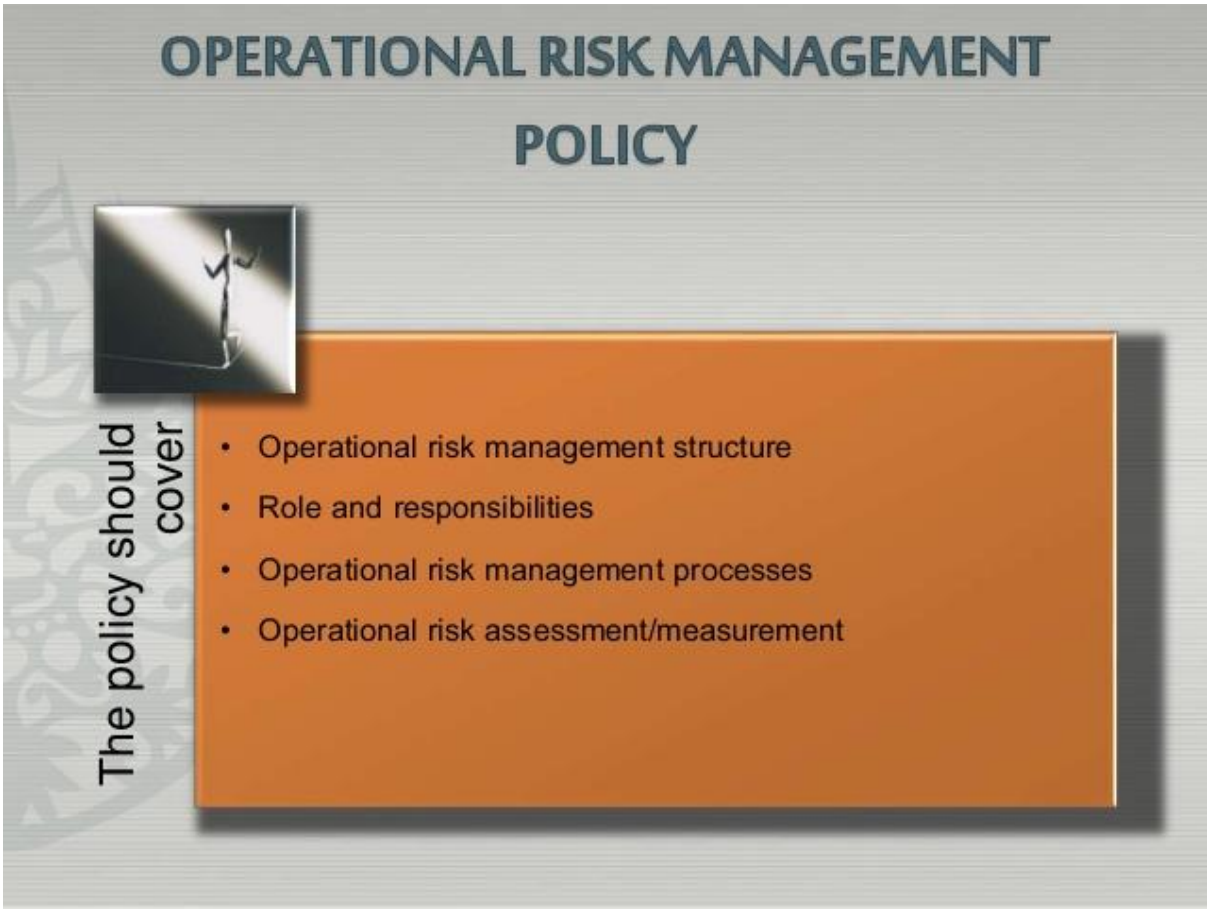
PRINCIPLE4 Banks should identify and assess OR inherent in all material products, processes and systems

PRINCIPLE 5 Banks should implement a process to regularly monitor OR profiles profiles and material exposures to losses.

PRINCIPLE 6 Banks should periodically review their risk limitation and control strategies and should adjust their OR profile accordingly using appropriate strategies.

PRINCIPLE 7 Banks should have in place contingency and business continuity plans to ensure their ability to operate on anon going basis and limit losses in the event of severe business disruption.

➢ OPERATIONAL RISK MANAGEMENT POLICY



➢ RISK MONITORING AND CONTROL PRACTICES

1) Collection of operational risk data
2) Regularmonitoringandfeedbackmechanisminplaceformonitoringanydeteriorationin operationalrisk profile
3) Collationofincidentreportingdatatoassessfrequencyandprobabilityof
4) occurrence of operational risk events
5) Monitoring and control of management of large exposure

➢ BENEFITS OF OPERATIONAL RISK

1) Control Education of operational loss.
2) Lower compliance/auditing costs.
3) Early detection of unlawful activities.
4) Reduced exposure to future risks.
5) Maintain Competitive Edge through Proactive Operational Risk Management
6) Clarified personal accountabilities, roles and responsibilities for managing operational risks
7) Sustained risk-smart workforce and environment
8) Ensured continuous risk management learning

MARKET RISK

- **'Market risk'**

Market risk is the risk that the value of an investment will decrease due to changes in market factors. These factors will have an impact on the overall performance on the financial markets and can only be reduced by diversification into assets that are not correlated with the market – such as certain alternative asset classes.

Market risk is sometimes called "systematic risk" because it relates to factors, such as a recession, that impact the entire market.

There are several different risk factors that make up market risk.

1) **Currency risk:** The risk that exchange rates will go up or possibly down

2) **Equity risk:** The risk that share prices will go up or down

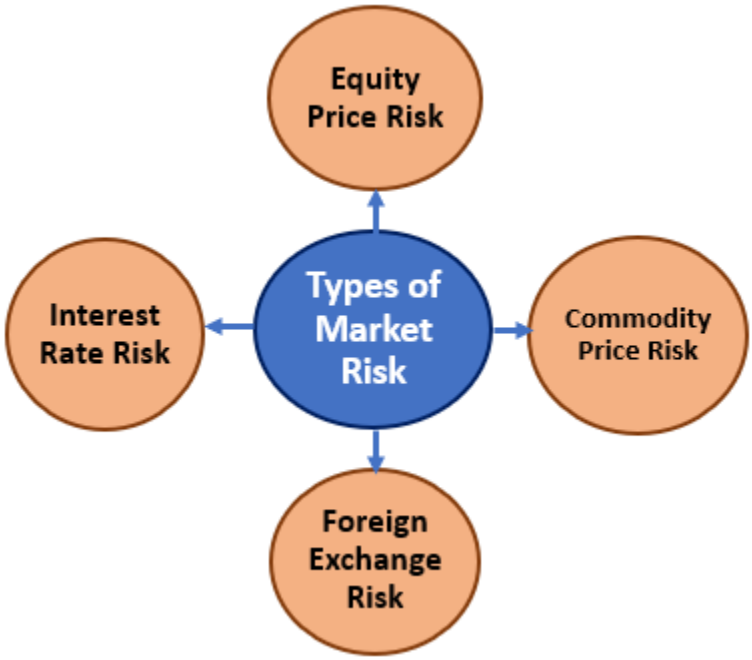
3) **Inflation risk:** the potential for inflation to increase the price of all goods and services such that it undermines the value of money

4) **Commodity risk:** the possibility of commodity prices such as metals change value dramatically

5) **Interest rate risk:** the risk that comes from an increase or decrease in interest rates

➢ TYPES OF MARKET RISK

There are four significant types of market risk.



#1 – Interest Rate Risk

Interest rate risk arises when the value of security might fall because of the increase and a decrease in the prevailing and long-term interest rates. It is a broader term and comprises multiple components like basis risk, yield curve risk, options risk, and repricing risk.

#2 – Foreign Exchange Risk

Foreign exchange risk arises because of the fluctuations in the exchange rates between the domestic currency and the foreign currency. The most affected by this risk is the MNCs that operate across geographies and have their payments in different currencies.

#3 – Commodity Price Risk

Like foreign exchange risk, commodity price risk arises because of fluctuations in commodities like crude, gold, silver, etc. However, unlike foreign exchange risk, commodity risks affect not only the multinational companies but also ordinary people like farmers, small business enterprises, commercial traders, exporters, and governments.

#4 – Equity Price Risk

The last component of market risk is the equity price risk, which refers to the change in the stock prices in the financial products. As equity is most sensitive to any change in the economy, equity price risk is one of the most significant parts of the market risk.

➢ MARKET RISK PREMIUM FORMULA

One factor used to calculate the gauge market risk is the calculation of market risk premium. Put market risk premium is the difference between the expected rate of return and the prevailing risk-free rate of return.

Mathematically market risk premium formula is as follows:

Market Risk Premium = Expected Return–Risk-Free Rate.

➢ ADVANTAGES OF MARKET RISK

Some advantages are as follows.

1) Most often than not, financial products are sold to the investor community by aggressive marketing and by presenting only the growth part while completely ignoring the risks and downfalls. This is why we see such products being bought more in the economic expansion cycles while in the recession, investors, especially the retail ones, are trapped. Had the investor known of the concept of market risk and its calculations, they can understand the financial products in a much better way and decide if it suits them for such volatilities.
2) The market risk premium, as explained in the example above, helps an investor to calculate the real rate of return. Even though the financial product might enjoy presenting a lucrative return, the investor should gauge the investment in terms of the actual rate it provides. This can be calculated by taking into account the prevailing risk-free interest rate and inflation rate.

➢ DISADVANTAGES OF MARKET RISK

Some disadvantages are as follows.

1) We cannot completely ignore them. It can only be hedged, which comes with a cost and intensive calculations. An investor must be apt to understand what data to analyze and what data it should filter out.

2) It is very prone to recession or cyclic changes in the economy. Ans since it affects the whole market simultaneously, it is even more challenging to manage as diversification will not help. Unlike credit risk, which is very much counterparty specific, it affects all asset classes.

CAPITAL ADEQUACY IN BANKING

➢ Historical development

Basel is a city in Switzerland. In 1974, all G-10 countries' Central Bank Governors met in Basel in order to see how banking could be improved through a common guidance. Various policies were developed since then, but the most important one became operational in 1988 which is called Basel I Capital Accord. Basel II Capital Accord was later developed in 2006 after series of revisions. Basel II is actually the basis of Capital Adequacy for all banks. Later, improvements were added and Basel III came up in 2010 and all Central (Reserve) Banks around the world are expected to implement the changes between 2013 and 2015 in their respective countries. However, an extension was granted for full convergence till 31st March 2019.

➢ What is Capital Adequacy?

Capital adequacy is the statutory minimum reserves of capital which a bank or other financial institution must have available – **Investopedia**

Under Basel III, the minimum capital adequacy ratio that banks must maintain is **8%**. The capital adequacy ratio measures a bank's capital in relation to its risk-weighted assets. The capital to risk-weighted assets ratio promotes financial stability and efficiency in economic systems throughout the world.

Capital Adequacy Ratio(CAR) is defined as:

$$\text{CAR} = \frac{\text{Tier 1 Capital + Tier 2 Capital}}{\text{Risk Weighted Assets (RWA)}}$$

Where:

1. TIER 1 CAPITAL = (paid up capital + statutory reserves + disclosed free reserves) – (equity investments in subsidiary + intangible assets + current & brought-forward losses)

2. **TIER 2 CAPITAL =** a) Undisclosed Reserves + b) General Loss reserves + c) hybrid debt capital instruments and subordinated debts
3. **The Risk Weighted Assets (RWA)** refer to the fund based assets such as Cash, Loans, Investments and other assets. They are the total assets owned by the Banks, however, the value of each asset is assigned a risk weight (for example 100% for corporate loans, 70% for mortgage loans and 60% non-collateral loans) and the credit equivalent amount of all off-balance sheet activities. Each credit equivalent amount is also assigned a risk weight.

Off-balance sheet items could be described as the transactions done outside the books of accounts like operating lease, guarantees, options and hedging of some financial instruments.

➢ Further Reading on 'Basel III'

*(Only for those who are still interested in the topic, otherwise, jump to "**Why do banks fail or collapse**")*

Basel III is part of the continuous effort to enhance the banking regulatory framework. It builds on the Basel I and Basel II documents and seeks to improve the banking sector's ability to deal with financial stress, improve risk management, and strengthen the banks' transparency. A focus of Basel III is to foster greater resilience at the individual bank level in order to reduce the risk of system-wide shocks.

- ***Minimum Capital Requirements***

Basel III introduced tighter capital requirements in comparison to Basel I and Basel II. Banks' regulatory capital is divided into Tier 1 and Tier 2, while Tier 1 is subdivided into Common Equity Tier 1 and additional Tier 1 capital. The distinction is important because security instruments included in Tier 1 capital have the highest level of subordination. Common Equity Tier 1 capital includes equity instruments that have discretionary dividends and no maturity, while additional Tier 1 capital comprises securities that are subordinated to most subordinated debt, have no maturity, and their dividends can be canceled at any time. Tier 2 capital consists of unsecured subordinated debt with an original maturity of at least five years.

Basel III left the guidelines for risk-weighted assets largely unchanged from Basel II. Risk-weighted assets represent a bank's assets weighted by coefficients of risk set forth by Basel III. The higher the credit risk of an asset, the higher its risk weight. Basel III uses credit ratings of certain assets to establish their risk coefficients.

In comparison to Basel II, Basel III strengthened regulatory capital ratios, which are computed as a percent of risk-weighted assets. In particular, Basel III increased minimum

Common Equity Tier 1 capital from 4% to 4.5%, and minimum Tier 1 capital from 4% to 6%. The overall regulatory capital was left unchanged at 8%.

- ***Countercyclical Measures***

Basel III introduced new requirements with respect to regulatory capital for large banks to cushion against cyclical changes on their balance sheets. During credit expansion, banks have to set aside additional capital, while during the credit contraction, capital requirements can be loosened. The new guidelines also introduced the bucketing method, in which banks are grouped according to their size, complexity, and importance to the overall economy. Systematically important banks are subject to higher capital requirements.

- ***Leverage and Liquidity Measures***

Additionally, Basel III introduced leverage and liquidity requirements to safeguard against excessive borrowings and ensure that banks have sufficient liquidity during financial stress. In particular, the leverage ratio, computed as Tier 1 capital divided by the total of on and off-balance assets less intangible assets, was capped at 3%.

In the United States, the minimum capital adequacy ratio is applied based on the tier assigned to the bank. The tier one capital of a bank to its total risk weighted exposure shouldn't go under 4 percent. The total capital, which comprises tier one capital plus tier two minus specific deductions, so the total risk-weighted credit exposure should stay above 8 percent.

➢ Why Do Banks Fail or Collapse?

From the aforementioned, you will see that for the bank to fail, its capital will be less than the 8% set. In other words, the following could lead to the results of its CAR being less than 8%: –

1. ***High defaults on its loans***: many banks take more than expected risk by lending to clients and sectors that are considered risky. In other words, they are not able to recover their loans leading to higher provision for loan losses and later write off of those loans. When this happens, its capital adequacy drops to a lower level as its capital has eroded by these write offs.
2. ***Diversion of clients deposits***: the majority of the financial institutions are in the habit of diverting clients' deposits into other long term fixed assets. You will see that most of the financial institutions have a construction or property development subsidiaries. Clients deposits are used to finance those projects. Now when the clients come to demand their deposits, they do not have the cash available since it is locked up in the property development project.
3. ***High Operating Costs***: the majority of the financial institutions hire a number of staffs that are not productive. To demonstrate that they are doing well, much money is invested

into advertising, uniforms, branding and image building. At long last, these all lead to high operating costs that eat up the profit and later eats up clients' deposits as in 2 above.

4. ***High staff turnover***: most experienced hands often resign and go to other financial institutions. There is a loss of institutional memory and procedures and policies are not followed as it should be.

➢ What will the Central Bank do if the financial institution is under distress?

The central bank would come with a number of suggestions to the financial institutions. It shall actually give it a deadline to address its capital adequacy issues or face revocation of its banking license.

The following are done by the Central Bank: –

1. Ask the Board of Directors of the bank to increase its capital base in order to absorb the losses quickly. This could be done with injection of fresh capital which may mean taking a new strategic partner(s) if the existing shareholders cannot inject more capital.
2. Without 1 above, the smoothest process is to allow another bank, which is more liquid and is of good standing, to take over the bank which is in distress. An example is what happened in Ghana in early August 2017 where two banks were taken over by the oldest commercial bank in that country.
3. The bank could also be liquidated completely by appointing an official liquidator. The liquidator will sell the liquidating banks' assets in order to defray the losses incurred. This last option normally causes hardships to depositors who will have to wait for all assets of the bank to be sold before they get their deposits back.

➢ Conclusion

Banks should concentrate on their core mandate instead of diverting clients' deposits into constructions, property developments, and fixed assets acquisitions. They should also stop the flamboyant lifestyles as displayed by many of the Banks and Savings & Loans in countries I was permitted to work. By this, they will be able to maintain a good capital adequacy ratio and continue to be in business.

➢ ISSUES OF BANK MANAGEMENT

As banks transition from the middle to the third phase of the transformation journey, they must navigate five broad challenges.

1. Managing emerging risks and increased competition: Broader geopolitical, social and environmental concerns are looming larger, as regulatory fragmentation continues and competition intensifies. FinTechs and major technology companies seek traction in profitable parts of financial services, while banks' strategic options to deliver 11% to 15% ROE narrow. Cyber security is now clearly the top risk for boards and CROs.
2. Leading a digital transformation of risk management: Technology has reshaped customer interfaces, but banks still have to implement new technologies in the middle and back office to drive fundamental change. Risk functions must change how they monitor risk profiles and enable innovation, and become smarter, faster and more cost-effective. New talent in technology and risk will be necessary, but hard to attract.
3. Operationalizing three-lines-of-defense models: Operationalization of the three-lines model is necessary to improve the effectiveness and cost-efficiency of risk management. Talent shortages are expected in advanced analytics, model risk and other key areas. Standardization and automation are accelerating, even if broader technology deployments are delayed.
4. Managing nonfinancial risks cost-effectively: Though conduct risk frameworks are in place, there is a long way to go to prove effectiveness and improve cost-efficiency. As risk appetite frameworks evolve, common challenges remain (e.g., expressing appetite for all risk types, cascading appetite to business units). Quantifying nonfinancial risks (e.g., reputational, strategic and cyber risks) remains difficult.
5. Staying resilient and protecting against cyber risks: Banks are rethinking what constitutes operational resiliency. Beyond core competencies (business continuity and disaster recovery), data quality and process-flow mapping need enhancing. In managing cyber risks across the three lines of defense, quantification and reporting are a challenge, even as boards increase oversight. Managing critical vendors more effectively supports operational and cyber-resiliency.

INVESTMENT BANKING

➢ Concept of Investment Banks

In the U.S., the Glass–Steagall Act, initially created in the wake of the Stock Market Crash of 1929, prohibited banks from both accepting deposits and underwriting securities, and led to segregation of investment banks from commercial banks. Glass–Steagall was effectively repealed for many large financial institutions by the Gramm–Leach–Bliley Act in 1999.

In a very broad perspective, Investment Banking as the term suggests, is concerned with the primary function of assisting capital market in the movement of financial resources from those who have them (investors) to those who want them (issuers).

The Dictionary of Banking and Finance defines 'investment bank' as a term used in the US to mean ' a bank which deals with the underwriting of new issues and advises corporations on their financial affairs.

➢ What Is an Investment Bank?

An investment bank is a special type of financial institution that aims to help companies access capital markets to raise money and take care of other business needs. A typical investment bank will engage in some or all of the following activities:

- Raise equity capital
- Raise debt capital
- Insure bonds or launching new products
- Engage in proprietary trading where teams of in-house money managers invest or trade the company's own money for its private account

For example, if Coca-Cola Enterprises wanted to sell $10 billion worth of bonds to build new bottling plants in Asia, an investment bank would help it find buyers for the bonds and handle the paperwork, along with a team of lawyers and accountants. Investment banks can also be involved in initial public offerings (IPOs) when a private market goes public and lists one of the exchanges.

➢ Structure of Investment Banking

Investment banks are organized into 3 categories:-

Front Office

1) Helping customers raise funds in the capital markets and advise on mergers and acquisitions
2) professional management of various securities and other assets

3) Buying and selling financial products with the goal of making money on each trade.
4) Creating and marketing financial products
5) Researching industries, companies, and products

Middle Office

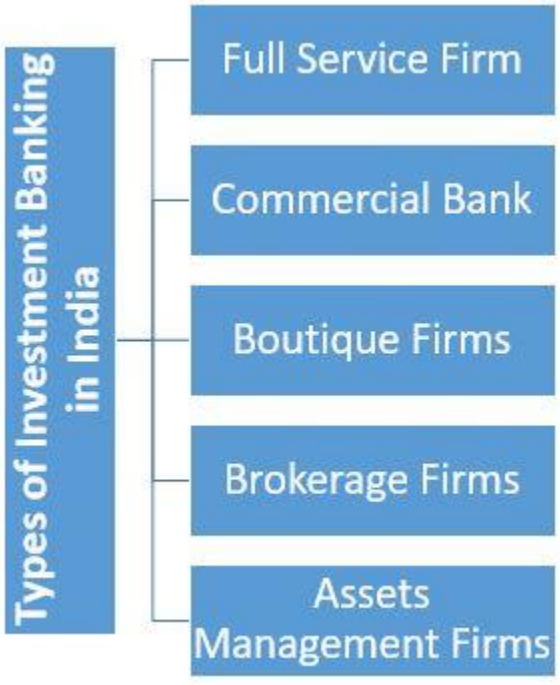
1) Analyzing credit and market risk for the bank
2) Making sure operations are complying with regulations
3) Responsible for capital management and risk monitoring

Back Office

1) Making sure the bank runs smoothly by submitting trades, maintaining databases, and transacting required money transfers
2) The information technology department

- **Different Types of Investment Banking in India**

  (Types of Investment Banks)



1. Full-Service Firms

The investment bank which has a presence in all types of areas like distribution, M&A (Mergers and acquisitions), brokerage, underwriting, asset management, and structured instrument, etc. These types of investment banks work with all types of corporations and individuals.

2. **Commercial Banks**

Commercial banks are serving in limited investment banking services in India (investment bank services in India). These commercial banks are allowed to work under section 20, which is a part of the subsidiary's forms under 20of the Glass – Steagall Act.

3. **Boutique Firms**

These types of firms are also limited to particular types of investment services. Boutique Firms are allowed to serve in some specific types of investment services.

4. **Brokerage Firms**

Brokerage firms are limited to provide investment services related to trading for retail investors as well as institutional clients. They have a large base of investors they are supposed to offer their services.

5. **Assets Management Firms**

Asset management firms are functioning in the investment services which include investment services like wealth management, fund management, cash management, and portfolio, etc. These firms also help in assisting the retail and corporate investors to choose

types of investment, the tenure of the corpus, types of the instrument, and the purpose of the investments.

➢ Functions of Investment Banking

1. Mergers and Acquisitions Advisory services:- M&A bankers specialize in providing companies with strategic advice when they plan to either merge with a competitor or acquire a smaller firm. The most fundamental and sound skill that these bankers require is Financial Modeling, which is what they base their suggestions or advices on. Highly ambitious individuals who are capable of working extremely long hours with great people skills, tend to pull out a 7 figure for salary as they progress their careers. Got the right skills? You might even become a legend executing some of the largest deals

2. Corporate financing Equity &Debt :- There are two types of **financing** available to a **company** when it needs to raise **capital**: **equity financing** and **debt financing**. **Debt financing** involves the borrowing of money whereas **equity financing** involves selling a portion of **equity** in the **company**

3. Underwriting:- A more traditional role for Investment Bankers has been to assist corporations and governments raising capital, which falls in the purview of the underwriting department. Bankers in this department specialize either in debt or equity and might also specialize by industry. These bankers need to be able to liaison with their clients in order to determine their capital needs while also working closely with traders and security sales personnel in order to determine the market situation and the price that any security may command in the market. As with most other investment bank jobs, underwriters might end up spending extra hours, when working on a deal

4. Equity and fixed income research :- The equity research group research, or "coverage", of securities helps investors make investment decisions and supports trading of stocks.

5. **Sales and trading-** Matching up buyers and sellers of securities in the secondary market. Sales and trading groups in investment banking act as agents for clients and also can trade the firm's own capital.

➢ Role of Investment Bank

1. The major work of investment banks includes a lot of consulting. For instance, they offer advices on mergers and acquisitions to companies. The other arena where they give advice are tracking the market and determining when should a company come out with a public offering and what is the best possible way to manage the public assets of businesses. The role that an investment bank plays sometimes gets overlapped with that of a private brokerage house. The usual advice of buying and selling is also given by investment banks.

2. There is no demarcating line between the investment banking and other forms of banking in India. This has been observed majorly of late. All banks nowadays want to provide their customers the best of services and create a niche for themselves and that is why apart from investment banks, all other banks too are aiming at making it big.

3. At the macro level, investment banking is related with the primary function of assisting the capital market in its function of capital intermediation, i.e., the movement of financial resources from those who have them (the investors), to those who need to make use of them for producing GDP (the issuers). Over the decades, investment banks have always suited the needs of the finance community and thus become one of the most vibrant and exciting segment of financial services.

4. Globally investment banks handle significant fund-based business of their own in the capital market along with their non-fund service portfolio which is offered to the clients. All these activities are broadly segmented across three platforms - equity market activity, debt market activity and merger and acquisitions (M&A) activity. In addition, given the structure of the market, there is also a segmentation based on whether a particular investment bank belongs to a banking parent or is a stand-alone pure investment bank.

5. Investment bank is a financial institution and investment banking plays a very important role in the economy. Investment banking helps the corporations in raising capital. It facilitates the trading of securities thereby, increasing the liquidity of the securities. It provides investment opportunities to the individuals or entities. Most of the corporations get advisory services from the investment banks regarding the mergers, acquisitions and divestiture. In addition, because of the importance of the roles of investment banking, the commercial banks do not perform these roles.

➢ Importance of Investment Banking

1) Helps the corporations in raising capital. It facilitates the trading of securities thereby, increasing the liquidity of the securities.
2) It provides investment opportunities to the individuals or entities.
3) Most of the corporations get advisory services from the investment banks regarding the mergers, acquisitions and divestiture.

➢ Problems Of Investment Banking

1) No Proper System Of Investment Banking In India
2) Lack Of Institutional Financing
3) Lack Of Depth In The Secondary Markets-Especially In the Corporate Debt Segment.

➢ Investment Banking in India

1) Grindlays bank began Investment Banking (Merchant Banking) in India in 1967 with RBI issuing the second license to Citi in 1970.
2) These two banks primarily provided services which included loan syndication, equity raising and other advisory services.
3) In 1972, a Banking Commission report asserted the need for Merchant Banking services in India by public sector banks.
4) The commission recommended the same structure as American investment banks (Glass-Steagall Act).
5) Merchant banks were meant to manage investments and provide advisory services.
6) SBI was the first Indian public sector bank to set up its merchant banking division in 1972.
7) This was followed by Bank of India, Central Bank of India, Bank of Baroda and many more.
8) SBI Caps and IDBI Caps are two prime examples of merchant banks in India today.
9) Currently, there are 136 merchant banks registered with SEBI.
10) Lastly, without holding a certificate of registration granted by the Securities and Exchange Board of India, no person can act as a merchant banker.

➢ Top 10 Investment Bankers in India

i. Vendus Capital
ii. Bajaj Capital
iii. Cholamandalam Investment & Finance Company
iv. ICICI Securities Ltd
v. IDFC
vi. Kotak Mahindra Capital Company
vii. SBI Capital Markets
viii. TATA Investment Corporation Ltd
ix. Yes Bank
x. UTI Securities Ltd
xi. Global Investment Bankers
xii. Bank of America (Bank of America Merrill Lynch)
xiii. Barclays (Barclays Capital)
xiv. BNP Paribas (BNP Paribas CIB)
xv. Citigroup (Citi Institutional Clients Group)
xvi. Credit Suisse
xvii. Deutsche Bank
xviii. Goldman Sachs
xix. HSBC
xx. JPMorgan Chase (J.P. Morgan Investment Bank)
xxi. Morgan Stanley
xxii. Nomura Holdings
xxiii. UBS (UBS Investment Bank)
xxiv. Royal Bank of Canada (RBC Capital Markets)
xxv. Royal Bank of Scotland
xxvi. Wells Fargo (Wells Fargo Securities)

➢ ANALYSIS BANK STATEMENT- PROFIT & LOSS ACCOUNT

Banking companies are required to prepare their Profit and Loss Account according to Form B in the Third Schedule. Form B is in a summary form and the details of various items are given in the Schedules.

Form B is given below:

Form of Profit & Loss Account
(for the year ended 31st March)

(000's omitted)

	Schedule No.	*Year ended* 31.3.20... (current year)	*Year ended* 31.3.20... (previous year)
I. Income			
Interest earned	13		
Other income	14		
Total			
II. Expenditure			
Interest expended	15		
Operating expenses	16		
Provisions and contingencies			
Total			
III. Profit / Loss			
Net profit / Loss (–) for the year			
Profit / Loss (–) brought forward			
Total			
IV. Appropriations			
Transfer to statutory reserves			
Transfer to other reserves			
Transfer to Government / Proposed dividend			
Balance carried over to balance sheet		x x x	x x x
Total			

6.

Schedules

Schedule 13 – Interest earned

	Year ended 31.3.20... (current year)	*Year ended* 31.3.20... (previous year)
I. Interest / discount on advances / bills		
II. Income on investments		
III. Interest on balances with Reserve Bank of India and other inter-bank funds		
IV. Others		
Total	x x x	x x x

Schedule 14 – Other Incomes

	Year ended 31.3.20... (current year)	*Year ended* 31.3.20... (previous year)
I. Commission, exchange and brokerage		
II. Profit on sale of investments		
Less : Loss on sale of investments		
III. Profit on revaluation of investments		
Less : Loss on revaluation of investments		
IV. Profit on sale of land, buildings and other assets		
Less : Loss on sale of land, buildings and other assets		
V. Profit on exchange transactions		
Less : Loss on exchange transactions		
VI. Income earned by way of dividends, etc. from subsidiaries / companies and / or joint ventures abroad / in India		
VII. Miscellaneous Income		
Total	x x x	x x x

Note : Under items II to V loss figures may be shown in brackets.

Schedule 15 – Interest expended

	Year ended 31.3.20... (current year)	*Year ended* 31.3.20... (previous year)
I. Interest on deposits		
II. Interest on Reserve Bank of India / inter-bank borrowings		
III. Others		
Total	x x x	x x x

7.

Schedule 16 – Operating expenses

	Year ended 31.3.20... (current year)	*Year ended* 31.3.20... (previous year)
I. Payments to and provisions for employees		
II. Rent, taxes and lighting		
III. Printing and stationery		
IV. Advertisement and publicity		
V. Depreciation on bank's property		
VI. Directors' fees, allowances and expenses		
VII. Auditors' fees and expenses (including branch auditors)		
VIII. Legal charges		
IX. Postage, telegrams, telephones etc.		
X. Repairs and maintenance		
XI. Insurance		
XII. Other expenditure		
Total	x x x	x x x

'RBI's Instruction'

Item	*Schedule*	*Coverage*	*Notes and instructions for compilation*
Interest earned	13	I. Interest/discount on advances/bills	Includes interest and discount on all types of loans and advances like cash credit, demand loans, overdrafts, export loans, term loans, domestic and foreign bills purchased and discounted (including those rediscounted), overdue interest and also interest subsidy, if any, relating to such advances / bills.
		II. Income on investments	Includes all income derived from the investment portfolio by way of interest and dividend.
		III. Interest on balances with Reserve Bank of India and other inter-bank funds	Includes interest on balances with Reserve Bank and other banks, call loans, moeny market placements, etc.
		IV. Others	Includes any other interest / discount income not included in the above heads.
Other income	14	I. Commisssion, exchange and brokerage	Includes all remuneration on services such as commission on collections, commission/exchange on remittances and transfers, commission on letters of credit, letting out of lockers and guarantees, commission on Government business, commission on other permitted agency business including consultancy and other services, brokerage, etc. on

8.

			securities. It does not include foreign exchange income.
		II. Profit on sale of investments *Less* : Loss on sale of investments	Includes profit / loss on sale of securities, furniture, and buildings, motor vehicle, gold, silver etc.
		III. Profits on revaluation of investments *Less* : Loss on revaluation of investments	Only the net position should be shown. If the net position is a loss, the amount should be shown as a deduction. The net profit/loss on revaluation of assets may also be shown under this item.
		IV. Profits on sale of land, buildings and other assets *Less* : Loss on sale of land, buildings and other assets.	
		V. Profit on exchange transactions *Less* : Loss on exchange transactions	Includes profit/loss on dealing in foreign exchange, all income earned by way of foreign exchange, commission and charges on foreign exchange transactions excluding interest which will be shown under interest. Only the net position should be shown. If the net position is a loss, it is to be shown as a deduction.
		VI. Income earned by way of dividends etc. from subsidiaries, companies, joint ventures abroad / in India	
		VII. Miscellaneous income	Includes recoveries from constituents for godown rents, income from bank's properties, security charges, insurance etc., and any other miscellaneous income. In case any item under this head exceeds one percent of the total income, particulars may be given in the notes.
Interest expended	15	I. Interest on deposits	Includes interest paid on all types of deposits including deposits from banks and other institutions.
		II. Interest on Reserve Bank of India / Inter-Bank borrowings	Includes discount / interest on all borrowings and refinance from Reserve Bank of India and other banks.

		III. Others	Includes discount/interest on all borrowings / refinance from financial institutions. All other payments like interest on participation certificates, penal interest paid, etc. may also be included here.
Operating expenses	16	I. Payments to and provisions for employees	Includes staff salaries, wages, allowances, bonus, other staff benefits like provident fund, pension, gratuity, liveries to staff, leave fare concessions, staff welfare, medical allowance to staff, etc.
		II. Rent, taxes and lighting	Includes rent paid by the banks on buildings and other municipal and other taxes paid (excluding income tax and interest tax) electricity and other similar charges and levies. House rent allowance and other similar payments to staff should appear under the head 'Payments to and provisions for employees.'
		III. Printing and stationery	Includes books and forms and stationery used by the bank and other printing charges which are not incurred by way of publicity expenditure.
		IV. Advertisement and publicity	Includes expenditure incurred by the bank for advertisement and publicity purposes including printing charges of publicity matter.
		V. Depreciation on bank's property	Includes depreciation on bank's own property, motor cars and other vehicles, furniture, electric fittings, vaults, lifts, leasehold properties, non-banking assets, etc.
		VI. Directors' fees, allowances and expenses	Includes sitting fees and all other items of expenditure incurred on behalf of directors. The daily allowance, hotel charges, conveyance charges, etc. which though in the nature of reimbursement of expenses incurred may be included under this head. Similar expenses of Local Committee members may also be included under this head.
		VII. Auditors' fees and expenses (including branch auditors' fees and expenses)	Includes fees paid to the statutory auditors and branch auditors for professional services rendered and all expenses for performing their duties.

10.

			even though they may be in the nature of reimbursement of expenses. If external auditors have been appointed by banks themselves for internal inspections and audits and other services, the expenses incurred in that context including fees may not be included under this head but shown under 'other expenditure'.
		VIII. Legal charges	All legal expenses and reimbursement of expenses incurred in connection with legal services are to be included here.
		IX. Postage, telegrams, telephones, etc.	Includes all postal charges like stamps, telegram, telephones, teleprinter, etc.
		X. Repairs and maintenance	Includes repairs to bank's property, their maintenance charges, etc.
		XI. Insurance	Includes insurance charges on bank's property, insurance premia paid to Deposit Insurance & Credit Guarantee Corporation etc. to the extent they are not recovered from the concerned parties.
		XII. Other expenditure	All expenses other than those not included in any of the other heads, like licence fees, donations, subscriptions to papers, periodicals, entertainment expense, travel expenses, etc. may be included under this head. In case any particular item under this head exceeds one percent of the total income, particulars may be given in the notes.
Provisions and contingencies	–		Includes all provisions made for bad and doubtful debts, provisions for taxation, provision for diminution in the value of investments, transfers to contingencies and other similar items.

➢ ANALYSIS BANK STATEMENT- BALANACE SHEET

Format A — Balance Sheet:

Balance Sheet should be prepared as per the revised format following the vertical method for its preparation including the last year's figure.

The Balance Sheet contains 12 Schedules which are:

- **Capital and Liabilities:**

1. Schedule I — Capital:- Capital is shown under the head "Capital and Liabilities" as first item.

2. Schedule II — Reserves and Surplus:

These includes:

(1) Statutory Reserve;

(2) Capital Reserves;

(3) Securities Premium;

(4) Reserve and other Reserves (including Profit and Loss Accounts). It is the second item under the head "Capital and Liabilities".

3. Schedule III — Deposits:

These include:

(1) Demand Deposits;

(2) Savings Bank Deposits;

(3) Term Deposits. It is the third items under the head "Capital and Liabilities".

4. Schedule IV — Borrowings:
These includes:

(1) Borrowings in India (RBI, other banks, other institutions and agencies);

(2) Borrowings outside India. It is the fourth item under the head "Capital and Liabilities".

5. Schedule V — Other Liabilities & Provisions:

These include:

(1) Bills Payable;

(2) Inter office Adjustment (Net);

(3) Accrued Interest;

(4) Others (including provisions).

It is the fifth item under the head "Capital and Liabilities".

- **Assets:**

6. Schedule VI — Cash and Balance with RBI:

These include:

(1) Cash in hand;

(2) Balances with RBI (in Current Account, in other accounts). It is the first item under the head "Assets".

7. Schedule VII — Balance with Banks and Money at Call & Short Notice:

These include:

(1) In India Balance with Banks (a) Current Account (b) Other Deposit Accounts; (c) Money at call and Short notice: ((i) With Banks; (ii) With other institutions).

It is the second item under the head "Assets".

8. Schedule VIII — Investments:

These include:

(1) Investment in India in Govt. Securities and others;

(2) Investments outside India in Govt. Securities and others.

It is the third item under the head "Assets".

9. Schedule IX — Advances:

These include:

(1) Bills purchased and discounted, Cash Credits, Overdrafts, and Term Loans;

(2) Secured by tangible assets;

(3) Advances in India.

(4) Advances outside India.

It is the fourth item under the head "Assets".

10. Schedule X — Fixed Assets:

These include:

(1) Premises;

(2) Other fixed assets.

It is the fifth item under the head "Assets".

11. Schedule XI — Other Assets:

These include:

(1) Inter-office Adjustment (Net);

(2) Accrued Interest;

(3) Tax paid in Advance;

(4) Stationery and stamps;

(5) Non-banking assets.

(6) Others.

It is the sixth item under the head "Assets".

12. Schedule XII — Contingent Liabilities:

These include:

(1) Claims against the bank not acknowledged as draft;

(2) Liability for partially paid investment;

(3) Liability against forward outstanding contract;

(4) Guarantee given on behalf of constituents;

(5) Acceptances, endorsements and other obligations;

(6) Other items

- **APPROPRIATION:-**

Only appropriation items will appear in this account viz, amount transferred to General Reserve or Statutory Reserve or Proposed Dividend etc. and the balance will appear in the Liability side of the Balance Sheet.

Revised Formats
THE THIRD SCHEDULE
(See Section 29)
Form A
FORM OF BALANCE SHEET

Balance Sheet of _____ (here enter the name of the Banking Company)

Balance Sheet as on 31st March (Year)

(000's omitted)

CAPITAL & LIABILITIES	Schedule	As on 31.3. — (Current Year)	As on 31.3. — (Previous Year)
Capital	1		
Reserve & Surplus	2		
Deposits	3		
Borrowings	4		
Other Liabilities and Provisions	5		
TOTAL			
ASSETS			
Cash and Balances with Reserve Bank of India	6		
Balance with banks and money at call and short notice	7		
Investments	8		
Advances	9		
Fixed Assets	10		
Other Assets	11		
TOTAL			
Contingent Liabilities			
Bills for collection	12		

Schedule 1 — Capital

	As on 31.3. — (Current Year)	As on 31.3. — (Previous Year)
I. **FOR NATIONALISED BANKS**		
Capital		
(Fully owned by Central Government)		

Contd.

	As on 31.3. — (Current Year)	As on 31.3. — (Previous Year)
II. **FOR BANKS INCORPORATED OUTSIDE INDIA**		
Capital		
(i) (The amount brought in by banks by way of start-up capital as prescribed by RBI should be shown under this head)		
(ii) Amount of deposit kept with the RBI under Section 11(2) of the Banking Regulation Act, 1949		
TOTAL		
III. **FOR OTHER BANKS**		
Authorised Capital (.....shares of Rs. each)		
Issued Capital (.....shares of Rs. each)		
Subscribed Capital (.....shares of Rs. each)		
Called-up Capital (.....shares of Rs. each)		
Less: Calls Unpaid		
Add: Forfeited Shares		

Schedule 2 – Reserves and Surplus

	As on 31.3. — (Current Year)	As on 31.3. — (Previous Year)
I. ***Statutory Reserves***		
Opening Balance		
Additions during the year		
Deductions during the year		
II. ***Capital Reserves***		
Opening Balance		
Additions during the year		
Deductions during the year		
III. ***Securities Premium***		
Opening Balance		
Additions during the year		
Deductions during the year		
IV. ***Revenue and other Reserves***		
Opening Balance		
Additions during the year		
Deductions during the year		
V. ***Balance in Profit and Loss Account***		
TOTAL		
(I, II, III, IV and V)		

Schedule 3 — Deposits

	As on 31.3. — (Current Year)	As on 31.3. — (Previous Year)
A. I. Demand Deposits		
(i) From Banks		
(ii) From Others		
II. Savings Bank Deposits		
III. Term Deposits		
(i) From Banks		
(ii) From Others		
TOTAL		
(I, II and III)		
B. (i) Deposits of branches in India		
(ii) Deposits of branches outside India		
TOTAL		

Schedule 4 — Borrowings

	As on 31.3. — (Current Year)	As on 31.3. — (Previous Year)
I. Borrowing in India		
(i) Reserve Bank of India		
(ii) Other Banks		
(iii) Other Institutions and Agencies		
II. Borrowings outside India		
TOTAL (I and II)		

Secured borrowings in I & II above –

Schedule 5 — Other Liabilities and Provisions

	As on 31.3. — (Current Year)	As on 31.3. — (Previous Year)
I. Bills Payable		
II. Inter-office adjustments (net)		
III. Interest Accrued		
IV. Others (including provisions)		
TOTAL		

Schedule 6 — Cash and Balances with Reserve Bank of India

	As on 31.3. — (Current Year)	As on 31.3. — (Previous Year)
I. Cash in Hand (including foreign currency notes)		
II. Balances with Reserve Bank of India		
(i) In Current Account		
(ii) In Other Accounts		
TOTAL (I & II)		

Schedule 7 — Balances with Banks and Money at Call & Short Notice

	As on 31.3. — (Current Year)	As on 31.3. — (Previous Year)
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		
TOTAL (I & II)		
II. Outside India		
(i) in Current Accounts		
(ii) in other Deposit Accounts		
(iii) Money at call and short notice		
TOTAL		
GRAND TOTAL (I & II)		

Schedule 8 — Investments

	As on 31.3. — (Current Year)	As on 31.3. — (Previous Year)
I. Investments in India in		
(i) Government Securities		
(ii) Other approved securities		
(iii) Shares		
(iv) Debentures and Bonds		
(v) Subsidiaries and/or Joint Ventures		
(vi) Others (to be specified)		
TOTAL		

Contd.

	As on 31.3.— (Current Year)	As on 31.3.— (Previous Year)
II. **Investments outside India**		
(i) Government Securities (Including local authorities)		
(ii) Subsidiaries and/or Joint Ventures abroad		
(iii) Other investments (to be specified)		
TOTAL		
GRAND TOTAL (I & II)		

Schedule 9 — Advances

	As on 31.3.— (Current Year)	As on 31.3.— (Previous Year)
A. (i) Bills purchased and discounted		
(ii) Cash Credits, Overdrafts and Loans payable on demand		
(iii) Term Loans		
TOTAL		
B. (i) Secured by tangible assets		
(ii) Covered by Bank/Government Guarantees		
(iii) Unsecured		
TOTAL		
C. I. **Advances in India**		
(i) Priority Sectors		
(ii) Public Sector		
(iii) Banks		
(iv) Others		
TOTAL		
II. **Advances outside India**		
(i) Due from Banks		
(ii) Due from others		
(a) Bills purchased and discounted		
(b) Syndicated Loans		
(c) Others		
TOTAL		
GRAND TOTAL (C. I & II)		

Schedule 10 — Fixed Assets

	As on 31.3.— (Current Year)	As on 31.3.— (Previous Year)
I. **Premises**		
At cost as on 31st March of the preceding year		
Additions during the year		
Deductions during the year		
Depreciation to date		
II. **Other Fixed Assets** (including Furniture and Fixtures)		
At cost as on 31st March of the preceding year		
Additions during the year		
Deductions during the year		
Depreciation to date		
TOTAL		
(I & II)		

Schedule 11 — Other Assets

	As on 31.3.— (Current Year)	As on 31.3.— (Previous Year)
I. Inter-office Adjustments (net)		
II. Interest Accrued		

Contd.

		As on 31.3.— (Current Year)	As on 31.3.— (Previous Year)
III.	Tax paid in advance/Tax deducted at source		
IV.	Stationery and Stamps		
V.	Non-banking assets acquired in satisfaction of claims		
VI.	Others @		
TOTAL			

@ In case there is any unadjusted balance of loss the same may be shown under this item with appropriate footnote.

Schedule 12 — Contingent Liabilities

		As on 31.3.— (Current Year)	As on 31.3.— (Previous Year)
I.	Claims against the bank not acknowledged as debts		
II.	Liability for partially paid investments		
III.	Liability on account of outstanding forward exchange contracts		
IV.	Guarantees given on behalf of constituents		
	(a) In India		
	(b) Outside India		
V.	Acceptances, endorsements and other obligations		
VI.	Other items for which the bank is contingently liable		
TOTAL			

FINANCIAL STATEMENT ANALYSIS WITH RATIO

❖ Meaning of Financial Statement Analysis:

The term 'financial analysis', also known as analysis and interpretation of financial statements', refers to the process of determining financial strengths and weaknesses of the firm by establishing strategic relationship between the items of the balance sheet, profit and loss account and other operative data.

"Analyzing financial statements," according to Metcalf and Titard, "is a process of evaluating the relationship between component parts of a financial statement to obtain a better understanding of a firm's position and performance."

❖ Objectives of Financial Statement Analysis:

(i) To assess the earning capacity or profitability of the firm.

(ii) To assess the operational efficiency and managerial effectiveness.

(iii) To assess the short term as well as long term solvency position of the firm.

(iv) To identify the reasons for change in profitability and financial position of the firm.

(v) To make inter-firm comparison.

(vi) To make forecasts about future prospects of the firm.

(vii) To assess the progress of the firm over a period of time.

(viii) To help in decision making and control.

(ix) To guide or determine the dividend action.

(x) To provide important information for granting credit.

❖ Types of Financial Statement Analysis:

1. Internal Analysis:-Internal analysis is made by the top management executives with the help of Management Accountant. The finance and accounting department of the business concern have direct approach to all the relevant financial records. Such analysis emphasis on the overall performance of the business concern and assessing the profitability of various activities and operations.

2. External Analysis:-Shareholders as investors, banks, financial institutions, material suppliers, government department and tax authorities and the like are doing the external analysis. They are fully depending upon the published financial statements. The objective of analysis is varying from one party to another.

3. Short Term Analysis:-The short term analysis of financial statement is primarily concerned with the working capital analysis so that a forecast may be made of the prospects for future earnings, ability to pay interest, debt maturities – both current and long term and probability of a sound dividend policy.

A business concern has enough funds in hand to meet its current needs and sufficient borrowing capacity to meet its contingencies. In this aspect, the liquidity position of the business concern is determined through analyzing current assets and current liabilities. Hence, ratio analysis is highly useful for short term analysis.

4. Long Term Analysis:-There must be a minimum rate of return on investment. It is necessary for the growth and development of the company and to meet the cost of capital. Financial planning is also necessary for the continued success of a company. The fixed assets

structure, leverage analysis, ownership pattern of securities and the like are made in the long term analysis.

5. Horizontal Analysis:-It is otherwise called as dynamic analysis. When financial statements for a number of years are viewed and analyzed, the analysis is called horizontal analysis. The preparation of comparative statements is an example of this type of analysis.

6. Vertical Analysis:-It is otherwise called as static analysis. Under this type of analysis, the ratios are calculated from the balance sheet of one year and/or from the profit and loss account of one year. It is used for short term analysis only.

❖ Methods of Financial Statement Analysis:

1. Comparative Statements:-Comparative statements deal with the comparison of different items of the Profit and Loss Account and Balance Sheets of two or more periods. Separate comparative statements are prepared for Profit and Loss Account as Comparative Income Statement and for Balance Sheets.

As a rule, any financial statement can be presented in the form of comparative statement such as comparative balance sheet, comparative profit and loss account, comparative cost of production statement, comparative statement of working capital and the like.

2. Comparative Income Statement:-Three important information are obtained from the Comparative Income Statement. They are Gross Profit, Operating Profit and Net Profit. The changes or the improvement in the profitability of the business concern is find out over a period of time. If the changes or improvement is not satisfactory, the management can find out the reasons for it and some corrective action can be taken.

3. Comparative Balance Sheet:-The financial condition of the business concern can be find out by preparing comparative balance sheet. The various items of Balance sheet for two different periods are used. The assets are classified as current assets and fixed assets for comparison. Likewise, the liabilities are classified as current liabilities, long term liabilities and shareholders' net worth. The term shareholders' net worth includes Equity Share Capital, Preference Share Capital, Reserves and Surplus and the like.

4. **Common Size Statements:-**A vertical presentation of financial information is followed for preparing common-size statements. Besides, the rupee value of financial statement contents are not taken into consideration. But, only percentage is considered for preparing common size statement

The total assets or total liabilities or sales is taken as 100 and the balance items are compared to the total assets, total liabilities or sales in terms of percentage. Thus, a common size statement shows the relation of each component to the whole. Separate common size statement is prepared for profit and loss account as Common Size Income Statement and for balance sheet as Common Size Balance Sheet.

5. Trend Analysis:-The ratios of different items for various periods are find out and then compared under this analysis. The analysis of the ratios over a period of years gives an idea of whether the business concern is trending upward or downward. This analysis is otherwise called as **Pyramid Method**.

6. Average Analysis:-Whenever, the trend ratios are calculated for a business concern, such ratios are compared with industry average. These both trends can be presented on the graph paper also in the shape of curves. This presentation of facts in the shape of pictures makes the analysis and comparison more comprehensive and impressive.

7. Statement of Changes in Working Capital:-The extent of increase or decrease of working capital is identified by preparing the statement of changes in working capital. The amount of net working capital is calculated by subtracting the sum of current liabilities from the sum of current assets. It does not detail the reasons for changes in working capital.

8. Fund Flow Analysis:-Fund flow analysis deals with detailed sources and application of funds of the business concern for a specific period. It indicates where funds come from and how they are used during the period under review. It highlights the changes in the financial structure of the company.

9. Cash Flow Analysis:-Cash flow analysis is based on the movement of cash and bank balances. In other words, the movement of cash instead of movement of working capital would be considered in the cash flow analysis. There are two types of cash flows. They are actual cash flows and notional cash flows.

10. Ratio Analysis:-Ratio analysis is an attempt of developing meaningful relationship between individual items (or group of items) in the balance sheet or profit and loss account. Ratio analysis is not only useful to internal parties of business concern but also useful to external parties. Ratio analysis highlights the liquidity, solvency, profitability and capital gearing.

11. Cost Volume Profit Analysis:-This analysis discloses the prevailing relationship among sales, cost and profit. The cost is divided into two. They are fixed cost and variable cost. There is a constant relationship between sales and variable cost. Cost analysis enables the management for better profit planning.

❖ Limitations Of Financial Analysis

(i) It is only a study of interim reports.

(ii) Financial analysis is based upon only monetary information and non-monetary factors are ignored.

(iii) It does not consider changes in price levels.

(iv) As the financial statements are prepared on the basis of a going concern, it does not give exact position. Thus accounting concepts and conventions cause a serious limitation to financial analysis.

(v) Changes in accounting procedure by a firm may often make financial analysis misleading.

(vi) Analysis is only a means and not an end in itself. The analyst has to make interpretation and draw his own.

RATIO ANALYSIS

❖ Meaning of Ratio Analysis

A ratio is a simple arithmetical expression of the relationship of one number to another. It may be defined as the indicated quotient of two mathematical expressions.

Ratio analysis is a technique of analysis &interpretation of financial statements. It is the process of establishing & interpreting various ratios for helping in making certain decision.

According to Myers,'' Ratio analysis is a study of relationship among the various financial factors in a business."

Thus , ratio analysis measures the profitability, efficiency & financial soundness of the business.

Ratio analysis is to present the figure of financial statement in a simple and intangible form. Ratio analysis, in this way , is the process of establishing meaningful relationship between two figures and set of financial statement.

Let us take an example. The income for the year from operations is let us say 1,00,000/- for a given year. The Purchases and other direct expenses cost around 75,000/-. So the Gross Profit f the year is 25,000/-. Now it can be said that the Gross Profit is 25% of the Operations Revenue. We calculate this as:-

G.P. Ratio = GPSales/Revenue ×100

G.P.Ratio = 25,0001,00,000 ×100

G.P. Ratio = 25%

One factor to be kept in mind is that ratio analysis is used only to compare numbers that make sense and give us a better understanding of the financial statement. Comparing random financial accounts should be avoided.

❖ Objectives of Ratio Analysis

Interpreting the financial statements and other financial data is essential for all stakeholders of an entity. Ratio Analysis hence becomes a vital tool for financial analysis and financial management. Let us take a look at some objectives that ratio analysis fulfils.

1] Measure of Profitability:-Profit is the ultimate aim of every organization. So if I say that ABC firm earned a profit of 5 lakhs last year, how will you determine if that is a good or bad figure? Context is required to measure profitability, which is provided by ratio analysis. Gross Profit Ratios, Net Profit Ratio, Expense ratio etc provide a measure of profitability of a firm. The management can use such ratios to find out problem areas and improve upon them.

2] Evaluation of Operational Efficiency:-Certain ratios highlight the degree of efficiency of a company in the management of its assets and other resources. It is important that assets and financial resources be allocated and used efficiently to avoid unnecessary expenses. Turnover Ratios and Efficiency Ratios will point out any mismanagement of assets.

3] Ensure Suitable Liquidity:-Every firm has to ensure that some of its assets are liquid, in case it requires cash immediately. So the liquidity of a firm is measured by ratios such as Current ratio and Quick Ratio. These help a firm maintain the required level of short-term solvency.

4] Overall Financial Strength:-There are some ratios that help determine the firm's long-term solvency. They help determine if there is a strain on the assets of a firm or if the firm is over-leveraged. The management will need to quickly rectify the situation to avoid liquidation in the future. Examples of such ratios are Debt-Equity Ratio, Leverage ratios etc.

5] Comparison:-The organizations' ratios must be compared to the industry standards to get a better understanding of its financial health and fiscal position. The management can take corrective action if the standards of the market are not met by the company. The ratios can also be compared to the previous years' ratio's to see the progress of the company. This is known as trend analysis.

❖ Advantages of Ratio Analysis

When employed correctly, ratio analysis throws light on many problems of the firm and also highlights some positives. Ratios are essentially whistleblowers, they draw the managements attention towards issues needing attention. Let us take a look at some advantages of ratio analysis.

1] Ratio analysis will help validate or disprove the financing, investment and operating decisions of the firm. They summarize the financial statement into comparative figures, thus helping the management to compare and evaluate the financial position of the firm and the results of their decisions.

2] It simplifies complex accounting statements and financial data into simple ratios of operating efficiency, financial efficiency, solvency, long-term positions etc.

3] Ratio analysis help identify problem areas and bring the attention of the management to such areas. Some of the information is lost in the complex accounting statements, and ratios will help pinpoint such problems.

4] Allows the company to conduct comparisons with other firms, industry standards, intra-firm comparisons etc. This will help the organization better understand its fiscal position in the economy.

❖ Limitations of Ratio Analysis

While ratios are very important tools of financial analysis, they d have some limitations, such as

1] The firm can make some year-end changes to their financial statements, to improve their ratios. Then the ratios end up being nothing but window dressing.

2] Ratios ignore the price level changes due to inflation. Many ratios are calculated using historical costs, and they overlook the changes in price level between the periods. This does not reflect the correct financial situation.

3] Accounting ratios completely ignore the qualitative aspects of the firm. They only take into consideration the monetary aspects (quantitative)

4] There are no standard definitions of the ratios. So firms may be using different formulas for the ratios. One such example is Current Ratio, where some firms take into consideration all current liabilities but others ignore bank overdrafts from current liabilities while calculating current ratio.

5] Accounting ratios do not resolve any financial problems of the company. They are a means to the end, not the actual solution.

❖ Types Of Ratio Analysis

Ratio Analysis

Name of the Ratio	Formula
1. LIQUIDITY RATIOS	Liquidity ratios measure the short-term solvency which means the ability of the enterprise to meet its short-term obligation as and when they become due.
(a) Current ratio	$\frac{Current\ Assets}{Current\ Liabilities}$ = ... : ..... C.A= Debtors- Provision on Debtors+ B/R+ Marketable securities+ Cash+ Accrued Incomes+ Stock + Prepaid Expenses C.L.= Trade Creditors+ B/P+ O/s Exp+ Bank O/D+ Provision for Tax Current ratio establishes a relationship between CA and CL.
(b) Quick Ratio (or Acid Test Ratio) (or Liquid Ratio)	$\frac{Quick\ Assets}{Curent\ Liabilities}$ = ... : ..... Notes: 1. Quick Assets= Current Assets-Stock-Prepaid Expenses 2. Working Capital= Current Assets- Current Liabilities Quick ratio establish a relationship between quick assets and CL.
(c) Super Quick Ratio or absolute Cash ratio	$\frac{Cash+Bank+Marketable\ Securities}{Curent\ Liabilities}$ = ... : .....
2. Solvency ratios	Solvency ratio measure the long-term financial solvency which means the enterprise's ability to pay the interest regularly and to repay the principal on maturity or in pre-determined installments at due dates.
(a) Debt-equity ratio	$\frac{Long\ Term\ Debt}{Shareholders\ Funds}$ = ... : ..... Note: Shareholder's Funds can be calculated as follows: 1. Equity Share Capital+ Preference Share Capital+ Reserves and Surplus- Fictitious Assets 2. Equity Share holder's Funds+ Preference Share Capital 3. Capital Employed- Long Term Debt 4. Net Fixed Assets+ Investment+ Working Capital- Long Term Debt 5. Net Fixed Assets+ Investment+ Current Assets- Current Liabilities- Long Term Debt 6. Total Assets- Total Debt Debt-equity ratio establishes a relationship between Long term debt and Share holders' fund.
(b) Total Assets Debt Ratio	$\frac{Total\ Assets}{Long\ Term\ Debt}$ = ... : ..... Total assets to debt ratio establish a relationship between Total assets and total long term debt.
(c) Proprietary Ratio	$\frac{Proprietor'S\ Funds}{Total\ Assets} \times 100$ = ...% Note: Proprietor's Funds = Shareholder's Funds

Ratio Analysis

	Proprietary ratio measures a relationship between proprietors' fund and the total assets.
(d) Interest Coverage Ratio	$\frac{\textbf{Net Profit Before Interest And Taxes}}{\textbf{Interest on Long Term Debt}}$ = ... Times Interest coverage ratio establishes a relationship between PBIT and interest on long term debt.
(e) Capital Gearing Ratio	$\frac{\textbf{Funds bearing Fixed Financial Payments}}{\textbf{Equity Shareholders Funds}}$
3. Activity Ratios	Activity ratios measure the effectiveness with which a firm uses its available resources. These ratio help in commenting on the efficiency of the enterprise in managing its assets.
(a) Stock Turnover Ratio	$\frac{\textbf{Cost of Goods Sold}}{\textbf{Average Stock}}$ =.... Times Notes: 1. Average Stock = $\frac{\textbf{Opening Stock+Closing Stock}}{2}$ 2. Cost Of Goods Sold = Net sales- Gross Profit OR COGS= Opening Stock+ Purchases+ Direct Expenses- Closing Stock Stock turnover ratio establish a relationship between cost of goods sold and average stock.
(b) Debtors Turnover Ratio	$\frac{\textbf{Net Credit Sales}}{\textbf{Average Debtors}}$ = ...Times Notes: 1. Average Debtors = $\frac{Op.Drs.+Op.B/R+Cl.Drs.+Cl.B/R}{2}$ 2. Net Credit Sales = Gross Credit Sales- Sales Return Or, = Net Sales- Cash Sales
(c) Average Debt Collection Period	$=\frac{\textbf{12 months or 52 weeks or 365 days}}{\textbf{Debtors turnover ratio}}$ = ... Period $=\frac{\textbf{Average Debtors}}{\textbf{Average Monthly / Weekly/ Daily Sales}}$ Note: Average Sales = $\frac{\textbf{Net Credit Sales}}{\textbf{12 months/52 weeks/365 days}}$
(d) Creditor's Turnover Ratio	$\frac{\textbf{Net Credit Purchase}}{\textbf{Average Creditors}}$=...Times Notes: 1. Average Creditors = $\frac{Op.Crs.+Op.B/P+Cl.Crs.+Cl.B/P}{2}$ 2. Net Credit Purchases = Gross Credit Purchases- Purchase Returns, = Net Purchases- Cash Purchases
(e) Average Debt Payment Period	$\frac{\textbf{12 months/52 weeks/365 days}}{\textbf{Creditors turnover ratio}}$=...Period

Ratio Analysis

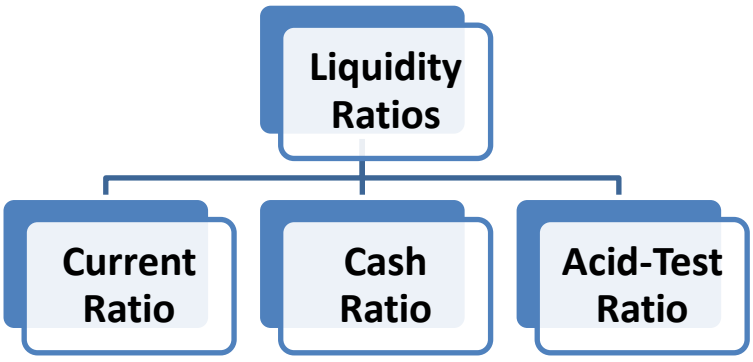
	Or=$\frac{Average\ Creditors}{Average\ Monthly\ /\ Weekly/\ Daily\ Sales}$ = ...Period Note: Average Purchases = $\frac{Net\ Credit\ Purchases}{12\ months/52\ weeks/365\ days}$
(f) Working Capital Turnover Ratio	$\frac{Net\ Sales}{Net\ Working\ Capital}$=...Times Note: Working Capital= Current Assets- Current Liabilities
4. Profitability Ratios	Profitability Ratios measures managements overall effectiveness as shown by the returns generated on sales and investments.
(I) In Relation to Sales	
(a) Gross Profit Ratio	$\frac{Gross\ Profit}{Net\ Sales}$ X 100=...% Note: Gross Profit= Net Sales- Cost of Goods Sold
(b) Operating Ratio	$\frac{Operating\ Cost}{Net\ Sales}$ X 100=...% Note: Operating Cost= Cost of Goods Sold+ Operating Expenses
(c) Operating Profit Ratio	$\frac{Operating\ Profit}{Net\ Sales}$ X 100=...% Note: Operating Profit= Net Sales- Operating Costs
(d) Net Profit Ratio	$\frac{Net\ Profit}{Net\ Sales}$ x 100=...% Notes: 1. Net Profit= Net Sales- Cost Of Goods Sold- Operating Expenses- Non Operating Expenses+ Non Operating Incomes 2. Net Profit= Gross Profit- Operating Expenses- Non Operating Expenses+ Non Operating Incomes 3. Net Profit= Operating Profit- Non Operating Expenses+ Non Operating Incomes
II. In Relation To Investment	
Return On Investment (ROI) OR Return On Capital Employed	$\frac{Net\ Profit\ Before\ Interest\ and\ Tax}{Capital\ Employed}$ X 100=...% Notes: 1. Capital Employed= Shareholder's Funds+ Long term debts OR = Net Fixed Assets+ Long Term Investment+ Net Working Capital 2. Non-Operating Assets do not form the part of Capital Employed 3. Income from Non Operating Assets should excluded be from the Net Profit Before Interest and Tax

I. Liquidity Ratios:-Accounting ratios are important because they assist the management in their day to day financial decisions. They also help them evaluate the performance of the firm and make any changes that are deemed necessary. One aspect that the management has to focus on is to ensure that the firm maintains a certain level of liquidity. Liquidity ratios help them determine that. Let us study them.

A firm has assets and liabilities to its name. Some are fixed in nature and then there are current assets and current liabilities. These are short-term in nature and easily convertible into cash. The liquidity ratios deal with the relationship between such current assets and current liabilities.

Liquidity ratios evaluate the firm's ability to pay its short-term liabilities, i.e. current liabilities. It shows the liquidity levels, i.e. how many of their assets can be quickly converted to cash to pay of their obligations when they become due.

It is not only a measure of how much cash there is but also how easily current assets can be converted to cash or marketable securities. Now let us look at some of the important liquidity ratios.



***(i) Current Ratio*:-**The current ratio is also known as the working capital ratio. It will measure the relationship between current assets and current liabilities. It measures the firm's ability to pay for all its current liabilities, due within the next one year by selling off all their current assets. The formula for is as follows

Current Ratio = Current Assets
Current Liabilities

- **Current Assets include,**

a) Stock

b) Debtors

c) Cash and Bank Balances

d) Bills receivable

e) Accruals

f) Short term loans that are given

g) Short term Securities

- **Current Liabilities include**

a) Creditors

b) Outstanding Expenses

c) Short Term Loans that are taken

d) Bank Overdrafts

e) Provision for taxation

f) Proposed Dividend

The ideal current ratio, according to the industry standard is 2:1. That means that a firm should hold at least twice the amount of current assets than it has current liabilities. However, if the ratio is very high it may indicate that certain current assets are lying idle and not being utilized properly. So maintaining the correct balance between the two is crucial.

For Example:- Q1:- Given Below is the Balance sheet of ABC Co. Analyze the Balance Sheet and Calculate the Current Ratio.

Liabilities	**Amount**	**Assets**	**Amount**
Share Capital	50,000	Fixed Asset	1,24,000
Preference Share Capital	30,000	Short Term Capital	10,000

General Reserve	40,000	Debtors	95,000
Debentures	60,000	Stock	50,000
Trade Payable	10,000	Cash and Bank	15,000
Bank Overdraft	20,000	Discount on Share Issue	6,000
Provision for Tax	40,000		
Provision for Depreciation	20,000		
	3,00,000		**3,00,000**

Solution:

Current Ratio = Current Assets/Current Liabilities

Current Assets = Debtors + Stock + Cash + Short term Capital = 1,70,000

Current Liabilities = Trade Payables + Bank Overdraft + Provision for Taxes + Provision for Depreciation = 90,000

Current Ratio = 17000090000 = 1.889 : 1

(ii) Quick Ratio:-The other important one of the liquidity ratios is Quick Ratio, also known as a liquid ratio or acid test ratio. This ratio will measure a firm's ability to pay off its current liabilities (minus a few) with only selling off their quick assets.

Now Quick assets are those which can be easily converted to cash with only 90 days notice. Not all current assets are quick assets. Quick assets generally include cash, cash equivalents, and marketable securities. The formula is

Quick Ratio = Quick Assets Current Liabilities/Quick Liabilities

Quick Assets = All Current Assets – Stock – Prepaid Expenses

Quick Liabilities = All Current Liabilities – Bank Overdraft – Cash Credit

The ideal quick ratio is considered to be 1:1, so that the firm is able to pay off all quick assets with no liquidity problems, i.e. without selling fixed assets or investments. Since it does not take into consideration stock (which is one of the biggest current assets for most firms) it is a stringent test of liquidity. Many firms believe it is a better test of liquidity than the current ratio since it is more practical.

Q 2: Calculate Liquid Ratio from the given details.

Current Liabilities	65,000
Current Assets	85,000
Stock	20,000
Advance Tax	5,000
Prepaid Expense	10,000

Solution:

Quick Ratio = Quick Assets Current Liabilities/Quick Liabilities

Quick Assets = All Current Assets – Stock – Prepaid Expenses

= 85000 – (20000+5000+10000) = 50,000

Quick Liabilities = All Current Liabilities – Bank Overdraft – Cash Credit = 65,000

Quick Ratio = 50000 / 65000 = 0.77:1

(iii) Absolute Cash Ratio:-This is an even more rigorous liquidity ratio than quick ratio. Here we measure the availability of cash and cash equivalents to meet the short-term commitment of the firm. We do not consider all current assets, only cash. Let us see the formula,

Absolute Cash ratio = Cash+Bank Balance +Marketable Securities Current Liabilities

As you can see, this ratio measures the cash availability of the firm to meet the current liabilities. There is no ideal ratio, it helps the management understand the level of cash availability of the firm and make any changes required.

However, if the ratio is greater than 1 it indicates poor resource management and very high liquidity. And high liquidity may mean low profitability.

II. Solvency Ratios:-Solvency ratios also known as leverage ratios determine an entity's ability to service its debt. So these ratios calculate if the company can meet its long-term debt. It is

important since the investors would like to know about the solvency of the firm to meet their interest payments and to ensure that their investments are safe. Hence solvency ratios compare the levels of debt with equity, fixed assets, earnings of the company etc.

One thing to make note of is the difference between solvency ratios and liquidity ratios. These two are often confused for the other. Liquidity ratios compare current assets with current liabilities, i.e. short-term debt. Whereas solvency ratios analyze the ability to pay long-term debt. Here we will be looking at the four most important solvency ratios. Let us start.

1] Debt to Equity Ratio:- The debt to equity ratio measures the relationship between long-term debt of a firm and its total equity. Since both these figures are obtained from the balance sheet itself, this is a balance sheet ratio. Let us take a look at the formula.

Debt to Equity Ratio = Long-Term Debt Shareholders Funds

Long Term Debt = Debentures + Long Term Loans

Shareholders Funds = Equity Share Capital + Preference Share Capital + Reserves – Fictitious Assets

The debt-equity ratio holds a lot of significance. Firstly it is a great way for the company to measure its leverage or indebtedness. A low ratio means the firm is more financially secure, but it also means that the equity is diluted.

In contrast, a high ratio indicates a risky business where there are more creditors of the firm than there are investors. In fact, a high debt to equity ratio may deter more investors from investing in the firm, and even deter creditors from lending money.

While there is no industry standard as such it is best to keep this ratio as low as possible. The maximum a company should maintain is the ratio of 2:1, i.e. twice the amount of debt to equity.

2] Debt Ratio:- Next, we learn about debt ratio. This ratio measures the long-term debt of a firm in comparison to its total capital employed. Alternatively, instead of capital employed, we can use net fixed assets. So the debt ratio will measure the liabilities (long-term) of a firm as a percent of its long-term assets. The formula is as follows,

Debt Ratio = Long-Term Debt Capital Employed

OR Long-Term Debt Net Assets

Capital Employed = Long Term Debt + Shareholders Funds

Net Assets = Non-Fictitious Assets – Current Liabilities

This is one of the more important solvency ratios. It indicates the financial leverage of the firm. A low ratio points to a more financially stable business, better for the creditors. A higher ratio points to doubts about the firms long-term financial stability. But a higher ratio helps the management with trading on equity, i.e. earn more income for the shareholders. Again there is no industry standard for this ratio.

3] Proprietary Ratio :- The third of the solvency ratios is the proprietary ratio or equity ratio. It expresses the relationship between the proprietor's funds, i.e. the funds of all the shareholders and the capital employed or the net assets. Like the debt ratio shows us the comparison between debt and capital, this ratio shows the comparison between owners funds and total capital or net assets. The ratio is as follows,

Proprietary Ratio = Shareholders Funds Capital Employed OR Shareholders Funds Net Assets

A high ratio is a good indication of the financial health of the firm. It means that a larger portion of the total capital comes from equity. Or that a larger portion of net assets is financed by equity rather than debt. One point to note, that when both ratios are calculated with the same denominator, the sum of debt ratio and the proprietary ratio will be 1.

4] Interest Coverage Ratio:- All debt has a cost, which we normally term as an interest. Debentures, loans, deposits etc all have an interest cost. This ratio will measure the security of this interest payable on long-term debt. It is the ratio between the profits of a firm available and the interest payable on debt instruments. The formula is,

Interest Coverage Ratio = Net Profit before Interest and Tax Interest on Long-Term Debt

- **Examples**

Q: Calculate Interest Coverage ratio from the following details:-

NPAT is 97,500

Tax Rate is 35%

Debentures are 6,00,000 at 10%

Solution:-NPAT = 1,25,000

Tax Rate = 35%

Net Profit before tax = (97500 × 100) ÷ 65

Net Profit Before tax = 1,50,000

Debentures Interest = 6,00,000 × 10% = 60,000

Interest Coverage Ratio = Net Profit before Interest and Tax Interest on Long-Term Debt = 15000060000

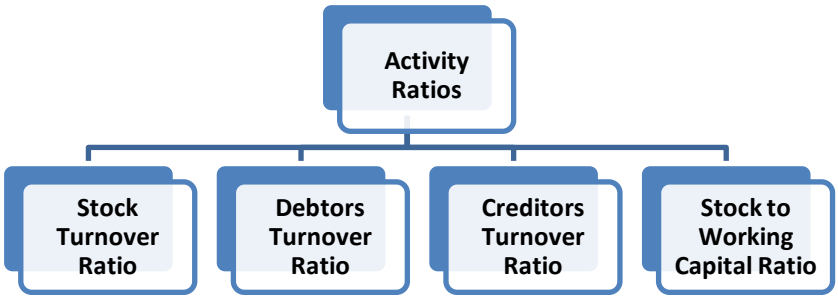
Interest Coverage Ratio = 2.5:1

So in the current earnings before interest and tax, the firm can cover the interest cost for 2.5 times.

III. Activity Ratios:-These ratios basically measure the efficiency with which assets are being utilized or managed. This is why they are also known as productivity ratio, efficiency ratio or more famously as turnover ratios.

These ratios show the relationship between sales and any given asset. It will indicate the ratio between how much a company has invested in one particular type of group of assets and the revenue such asset is producing for the company.

The following are the different kinds of activity ratios that measure the effectiveness of the funds invested and the efficiency of their performance



1] Stock Turnover Ratio:-One of the most important of the activity ratios is the stock turnover ratio. This ratio focuses on the relationship between the cost of goods sold and average stock. So it is also known as Inventory Turnover Ratio or Stock Velocity Ratio.

It basically counts the number of times a stock rotates (completes a cycle) in one given accounting period and the sales it effects in the same period. So it calculates the speed with which the company converts stock (lying about) to sales, i.e. revenue. The formula for the ratio is as follows,

Quick Ratio = COGS Average Stock

COGS = Sales – Gross Profit

Average Stock = Opening Stock+ClosingStock2

From a managerial standpoint, this is an important ratio to calculate. It allows them to figure out their inventory reordering schedule, by indicating when all the stock will run out. It also helps them analyze how efficiently the stock and its reordering is being managed by the purchasing department.

2] Debtors Turnover Ratio:-This ratio measures the efficiency with which Accounts Receivable are being managed, hence it is also known as 'Accounts Receivable Turnover ratio'. The ratio shows the equation between credit sales (cash sales are not taken into consideration) and the average debtors of a firm. The formula is as below

Debtors Turnover ratio = Credit Sales Average Debtors OR
Debtors Turnover ratio = Credit Sales Debtors +Bills Receivable

And with a slight modification, we also derive the average collection period. This will indicate the average number of days/weeks/months in which the payment from the debtor is collected by a firm. The formula for this formula is as below,

Average Collection Period = Number of days/weeks/months Debtors T/O Ratio

Both of these ratios are significant in managing the debtors and bills receivables of a company. Not only do they calculate the velocity with which debtors pay up, they help shape the credit policy of the firm as well.

3] Creditors Turnover Ratio:-This ratio shows the relation between credit purchases (cash purchases are ignored in this context) and the average creditors of a company at any given time of the accounting year. This ratio is also the 'accounts payable turnover ratio'. While calculating the net purchases we will minus any purchase return. The formula is as below,

Creditors Turnover ratio = Credit Purchases Average Creditors OR
Creditors Turnover ratio = Credit Purchases Creditors +Bills Payable
Average Creditors = OpeningCreditors+ClosingCreditors2

Now using the same ratio, we can also calculate the average payment period in the number of days/weeks/months. We only have to modify the ratio a little, and remember this will be expressed as a function of time (days, moths etc)

Average Payment Period = Number of days/weeks/months Creditors T/O Ratio

Again creditors turnover ratio has great importance. It calculates the velocity with which creditors are paid off during the year. It helps the management judge how efficiently the accounts payables are being handled.

4] Working Capital Turnover Ratio:-This one of the activity ratios will measure the efficiency with which the firm is using their Working Capital to support their sale volumes. So any excess of current assets over the current liabilities of a firm is their working capital. The formula for the ratio is

Working Capital Turnover ratio = Total Sales Working Capital

Working Capital = Current Assets – Current Liabilities

A high Working Capital Turnover ratio means that the working capital is being very efficiently utilized. But sometimes it could mean that the creditors of the company are excessive (bringing down the working capital) and this could be a problem in the future. Conversely, a low ratio could mean that there are too many debtors or a very big inventory which is not an efficient use of resources.

Solved Example:-Q1: Calculate Debtors Turnover Ratio and Average Collection Period (in days) from the following.

Total Sales – 6,00,000
Cash Sales – 20% of Total sales
Trades Receivable at beginning of the year- 80,000
Trades Receivable at the end of the year- 1,60,000

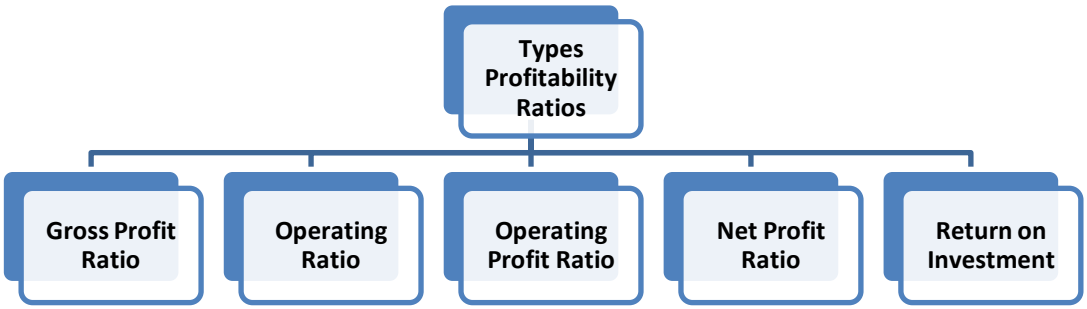
Solution:-Credit Sales = 80% of Total Sales = 80% of 6,00,000 = 4,80,000

Average Debtors = OpeningDebtors+ClosingDebtors2
= 80,000+1,60,0002 = 1,20,000
Debtors Turnover ratio = Credit Sales/ Average Debtors
= 480000/120000
= 4 times
Average Collection Period = Number of days/weeks/months Debtors T/O Ratio
= 3654
= 91.25 days = 92 days

IV. Profitability Ratio:-Profitability refers to the financial performance of the business. Accounting Ratios that measure profitability are known as Profitability Ratios. We express these ratios in '**Percentage**'.

Types of Profitability Ratio

Profitability Ratios are of five types. These are:



(i) Gross Profit Ratio:-Gross Profit Ratio establishes the relationship between gross profit and Revenue from Operations, i.e. Net Sales of an enterprise. Thus,

Gross Profit Ratio = (Gross Profit/Revenue from Operations) x 100

Revenue from operations means revenue earned by the enterprise from its operating activities. It includes Net Sales and commission, etc., in the case of non-finance companies and interest earned, dividend, profit on the sale of securities, etc., in the case of finance companies.

Gross Profit = Revenue from Operations – Cost of Revenue from Operations

(Cost of operations is also called as Cost of Goods Sold)

Cost of Revenue from Operations = Opening Inventory + Net Purchases + Direct Expenses – Closing Inventories. **Or**

= Revenue from Operations – Gross Profit

- **Objective:**

The main objective of computing Gross Profit Ratio is to determine the efficiency of the business. We can also compare this ratio with the ratio of earlier years or with that of other firms to compare and to assess the efficiency of the business. Therefore, Higher Gross Profit Ratio is better as it leaves a higher margin to meet operating expenses and the creation of reserves.

(ii) Operating Ratio:- It establishes the relationship between operating costs and Revenue from Operations. Operating cost includes Cost of Revenue from Operations and Operating Expenses. These are those costs which are incurred for operating activities of the business.

Operating Ratio = (Cost of Revenue from Operations + Operating Expenses/Revenue from Operations) x 100 **Or**

=(Operating cost/Revenue from Operations) x 100

Operating Expenses = Employees Benefit Expenses + Depreciation and Amortization Expenses + Other Expenses (Other than Non-operating Expenses) **Or**

= Office Expenses + Selling and Distribution Expenses + Employees Benefit Expenses + Depreciation and Amortization Expenses.

We should keep in mind that Operating Profit Ratio and Operating Ratio are complementary to each other and thus if we deduct one of the two ratios from 100, another ratio will obtain.

Operating Ratio + Operating Profit Ratio = 100

- **Objective:**

The objective of computing Operating Ratio is to assess the operational efficiency of the business.

Lower Operating Ratio is better because it leaves a higher profit margin to meet non-operating expenses, to pay the dividend, etc. A rise in the Operating Ratio indicates a decline in efficiency.

(iii)Operating Profit Ratio:-Operating Profit Ratio measures the relationship between Operating Profit and Revenue from Operations, i.e. Net Sales.

We compute Operating Profit Ratio by dividing operating profit by revenue from operations (Net Sales) and is express in Percentage.

Operating Profit Ratio = (Operating Profit/Revenue from Operations) x 100

Operating Profit = Gross Profit + Other Operating Income – Other Operating Expenses **Or,**

= Net Profit (Before Tax) + Non-operating Expenses – Non-operating Income **Or,**

= Revenue from Operations – Operating Cost

- **Objective:**

The objective of computing Operating Profit Ratio is to determine the operational efficiency of the business. An increase in the ratio over the previous period shows improvement in the operational efficiency of the business enterprise.

(iv) Net Profit Ratio:-Net Profit Ratio measures the relationship between Net Profit and Net Sales. It shows the percentage of Net Profit earned on Revenue from Operations.

Net Profit Ratio = (Net Profit/Net Sales) x 100

Net Profit = Revenue from Operations – Cost of Revenue from Operations – Operating Expenses – Non-operating Expenses + Non-operating Incomes – Tax

- **Objective:**

a) Net Profit Ratio indicates the overall efficiency of the business.

b) Higher the Net Profit Ratio, better is the business. An increase in the ratio over the previous year shows improvement in operational efficiency.

(v) Return on Investment:-Return on Investment or Return on Capital Employed shows the relationship of profit (profit before interest and tax) with capital employed. The result of operations of a business is either profit or loss.

The funds or sources used in the business to earn profit/loss are proprietors' (shareholders') funds and loans.

Return on Investment = (Net Profit before Interest, Tax and Dividend/Capital Employed) x 100

We compute Capital Employed by Liabilities Approach or by Assets Approach. We should keep in mind, whichever approach we will follow; the amount of capital employed will be the same.

- **Liabilities Approach:**

Capital Employed = Shareholder' Fund + Non-current Liabilities.

(In case, Surplus balance is there in Statement of Profit and Loss, we will deduct the amount of surplus to calculate the Shareholder' Fund)

- **Assets Approach:**

Capital Employed = Non-current Assets + Working Capital.

Where, **Non-current Assets = Fixed assets + Non-current Trade Investments + Long-term Loans and Advances.**

Working Capital = Current Assets – Current Liabilities

Solved Example on Profitability Ratio

Q1. Revenue from Operations ₹ 8,00,000; Gross Profit Ratio 25%; Operating Ratio 90%; Non-operating Expenses ₹ 4,000; Non-operating Income ₹ 44,000.Calculate Net Profit Ratio.

Solution:-Net Profit Ratio = Net Profit Net Sales x 100

= 120000800000 x 100 = 15%

***Working notes*:**

Operating Profit Ratio = 100 – Operating Ratio = 100 – 90 = 10%

Operating Ratio = ₹ 8,00,000 x 10% = ₹ 80,000.

Net Profit = Operating Profit + Non-operating Incomes – Non-operating Expenses

= ₹ 80,000 + ₹ 44,000 – ₹ 4,000 = ₹ 1,20,000.

Q2. XYZ Company's financial statements contain the following information:

	2007 *Rs.*	*2008* *Rs.*
Cash	2,00,000	1,60,000
Sundry Debtors	3,20,000	4,00,000
Temporary Investments	2,00,000	3,20,000
Stock	18,40,000	21,60,000
Prepaid Expenses	28,000	12,000
Total Current Assets	25,88,000	30,52,000
Total assets	56,00,000	64,00,000
Current Liabilities	6,40,000	8,00,000
Loans	16,00,000	16,00,000
Capital	20,00,000	20,00,000
Retained Earnings	4,68,000	8,12,000

Statement of Profit for the Current Year

	Rs.
Sales	40,00,000
Less cost of goods sold	(28,00,000)
Less interest	(1,60,000)
Net profit	10,40,000
Less taxes @ 50%	5,20,000
Profit after taxes	5,20,000
Profit distributed	2,20,000

From the above, appraise the financial position of the company from the point of view of (*i*) Liquidity, (*ii*) Profitability, and (*iii*) Activity.

SOLUTION

1. **Liquidity Ratios**

(*a*) Current Ratio (2008) $= \frac{\text{Current Assets}}{\text{Current Liabilities}} = \frac{30,52,000}{8,00,000} = 3.81$

(*b*) Acid Test Ratio (2008) $= \frac{\text{Liquid Assets}}{\text{Current Liabilities}} = \frac{30,52,000 - 21,72,000}{8,00,000} = 1.1$

2. Leverage Ratios:

(a) Debt Equity Ratio (2008) = $\frac{\text{Long term debts}}{\text{Equity Funds}} = \frac{16,00,000}{28,12,000} = .57$

(b) Interest Coverage Ratio (2008) = $\frac{\text{EBIT}}{\text{Interest Charge}} = \frac{12,00,000}{1,60,000} = 7.5 \text{ times.}$

3. Profitability Ratios:

(a) Gross Profit Ratio (2008) = $\frac{\text{Gross Profit}}{\text{Sales}} \times 100 = \frac{12,00,000}{40,00,000} \times 100 = 30\%$

(b) Net Profit Ratio (2008) = $\frac{\text{Net Profit}}{\text{Sales}} \times 100 = \frac{5,20,000}{40,00,000} \times 100 = 13\%$

(c) Return on Total Assets (2008) = $\frac{\text{Profit after Tax}}{\text{Total Assets}} \times 100 = \frac{5,20,000}{64,00,000} \times 100 = 8.12\%$

(d) Return on Cap. Empl. (2008) = $\frac{\text{PAT + Int (1 – t)}}{\text{Total Cap. Emp.}} \times 100 = \frac{5,20,000 + 80,000}{44,12,000} \times 100 = 13.6\%$

(e) Return on equity funds (2008) = $\frac{\text{Profit after tax}}{\text{Equity funds}} \times 100 = \frac{5,20,000}{28,12,000} \times 100 = \text{Rs. } 18.5\%$

4. Activity Ratios: ***Rs.***

(a) Debtors Turnover (2008) = $\frac{\text{Sales}}{\text{Average Debtors}} = \frac{40,00,000}{3,60,000} = 11.1 \text{ times}$

(b) Stock Turnover (2008) = $\frac{\text{Cost of goods sold}}{\text{Average Stock}} = \frac{28,00,000}{20,00,000} = 1.4 \text{ times}$

(c) Total Assets Turnover (2008) = $\frac{\text{Sales}}{\text{Average Assets}} = \frac{40,00,000}{60,00,000} = .67 \text{ times.}$

IMPORTANT QUESTION:-

❖ SHORT QUESTIONS (2 MARKS):-

1) Credit Risk
2) Liquidity Risk
3) Market Risk
4) Investment Risk
5) Interest Risk
6) Operational Risk

❖ LONG QUESTIONS (10 MARKS):-

7) Define Interest Rate Risk Management? Discussed its Types & Principles, Limitations?

8) Write Detailed note on Bank Statement Analysis?

9) Write the Short notes:-
a) Credit Risk
b) Liquidity Risk

10) Discuss the concept of Investment Banking and its Services?

11) Discuss the issues f Bank Management?

12) Write the Short notes:-
a) P & L under Bank Statement analysis
b) Balance Sheet under Bank Statement Analysis

13) Define Ratio? Explain its types and also give the examples?
14) Write the detail note of Financial Performance analysis.

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