UNIVERSITY GRANTS COMMISSION

COMMERCE **CODE: 08**

UNIT: 7 BANKING AND FINANCIAL INSTITUTIONS

SYLLABUS

SECTION – 1: Unit at a Glance

Sub Unit 1: Overview of Indian financial system

Overview of Indian Financial system

The financial system refers to set of complex and interconnected components consisting financial institutions, financial markets, financial instruments, financial regulators and financial services. The aim of the financial system is to facilitate the circulation of funds in an economy.

Components of Indian financial system

There are five components of Indian Financial system namely, Financial institutions, financial markets, financial assets or instruments or securities, financial services and financial regulators.

Functions of Indian Financial system

- The financial system helps in optimal allocation of financial resources in an economy.
- It helps in establishing a link between savers and investors.
- The financial system allows 'asset-liability change'. When they accept deposits from customers, banks make claims against themselves, but they also make assets when providing loans to customers.

Sub Unit: 2 Types of banks: Commercial banks; Regional Rural Banks (RRBs); Foreign banks; Cooperative banks

Types of Banks

Banks can be broadly be classified as Commercial Banks, Small Finance bank, Payment Banks and Co-Operative Bank

Functions of commercial banks

- **Accepting Deposits**
- **Advancing Loans**
- Collection and payment of rent, interest and dividend.
- Collection and payment of cheques and bills.
- Buying and selling securities.
- Payment of insurance premium and subscriptions.
- Safekeeping of valuables, documents etc., in locker or vault.
- ATM card, credit card and debit card facility.
- Issue of demand draft, pay order and travellers cheque.
- Internet and mobile banking
- Sale of application forms of competitive exams.
- Transfer of funds
- Credit Creation

Objectives of Nationalisation of Banks

- To mobilise savings of the people to the maximum possible extent and utilise them for productive purposes;
- To meet the legitimate credit needs of private sector industry and trade (big or small);
- To counter the menace of money lenders;
- To bring about development and financial inclusion in rural areas to benefit farmers and other small scale/cottage industries;
- To increase the reach of bank towards rural areas i.e. to counter the urban bias;
- To make the banking industry tilt towards social purpose instead of profit making org. as was the trend then;
- To check (stop) the use of the bank credit for speculative and other unproductive purposes.

Sub Unit: 3 Reserve Bank of India: Functions; Role and monetary policy management Organisations and Management of RBI

The Reserve Bank's operations are governed by a central board of directors; RBI is on the whole operated with a 21-member central board of directors appointed by the Government of India in accordance with the Reserve Bank of India Act.

The Central board of directors comprise of:

- Official Directors – The governor who is appointed/nominated for a period of four years along with four Deputy Governors
- Non-Official Directors – Ten Directors from various fields and two government Official

Objectives of RBI

The Preamble of the Reserve Bank of India describes the basic objectives of the Reserve Bank as:

- Regulating the issue of Banknotes
- Securing monetary stability in India
- Modernising the monetary policy framework to meet economic challenges

Functions of RBI

- Formulating and implementing the national monetary policy.
- Maintaining price stability across all sectors while also keeping the objective of growth.
- Set parameters for banks and financial operations within which banking and financial systems function.
- Protect investors' interest and provide economic and cost-effective banking to the public.
- Oversees the Foreign Exchange Management Act, 1999.
- Facilitate external trade and development of foreign exchange market in India.
- Issue of Notes
- Promotes and performs promotional functions to support national banking and financial objectives.
- Banker to Government:
- **Banker's Bank**
- **Controller of the Credit**

Monetary policy Management

Monetary policy is the macroeconomic policy laid down by the central bank. It involves management of money supply and interest rate and is the demand side economic policy used by the government of a country to achieve macroeconomic objectives like inflation, unemployment, consumption, growth and liquidity.

Expansionary vs. contractionary monetary policy

In **Expansionary** monetary policy central bank increase the money supply by reducing interest rate, lower the reserve requirement of the banks and purchase government securities.

On the other hand in case of **Contractionary** monetary policy central bank reduce the money supply in the market by increasing interest rate, selling government bonds and increasing reserve requirement of the banks.

Tools of monetary policy

Central banks use the following tools to implement the monetary policy measures-

- Interest rate adjustment
- Change Reserve requirement
- Open market operation

Types of banking System

i) Branch Banking
ii) Unit Banking/Localized banking
iii) Group banking
iv)Corresponding banking
v) Investment Banking
vi)Offshore Banking
vii) Narrow Banking
viii) Universal Banking
ix) Merchant banking
x) Relationship banking
xi) Indigenous Banking
xii) Development banking

Sub Unit 4: Banking sector reforms in India: Basel norms; Risk management; NPA management

Objectives of banking sector reforms in India:

- Reforms were aimed at bringing a transformation change in the structure, efficiency and stability of the banking system, and also integration with the international markets.
- To make Indian banks, internationally competitive and encourage them to play an effective role in accelerating the process of growth.
- The reforms in the banking sector in India intended to enhance the stability and efficiency of banks
- To remove the operational rigidities in the credit delivery system to ensure allocation efficiency and achievement of social objectives.

Basel Norms

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. In fact, on a few parameters the RBI has prescribed stringent norms as compared to the norms prescribed by BCBS.

Risk Management

A risk in banks can be defined as the uncertainty in future income.

Types of Risk in banking Sector can be classified as

- Credit Risk
- Market Risk
- Liquidity Risk
- Operational Risk
- Reputation Risk
- Systematic Risk

Risk management strategies

- Risk Identification
- Risk Analysis
- Risk Reduction
- Risk sharing
- Risk Retaining
- Risk Monitoring
- Risk Transfer

NPA Management

When an individual fails to repay or return the money borrowed from a lender, then such kind of a loan becomes nonperforming in the books of financial institutions. There is no guarantee whether a lender can receive the money lent to the borrower. It is those assets which cease to generate any return to the bank. A non -performing asset (NPA) is a classification used by the financial institution for loan or advance on which the principal is past due and no interest payment have been made for a period of 90 days or more.

Types of NPAs

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

Standard assets

Substandard

Doubtful Debts

Loss Assets

Sub Unit: 5 Financial markets: Money market; Capital market; Government securities market

Financial Market

It is a market where financial instruments or securities are traded between buyer and seller. Financial market can be classified as money market and capital market. Again money market can be classified as organised money market and unorganised money market. On the other hand capital market can be classified as primary market and secondary market.

Participant of primary market

The main participants of the primary market are issuer companies, the investing public and institutions, the government, underwriters, merchant bankers, etc.

Participant of secondary market

The main participants of the secondary marker are buyers and sellers of the securities, Government, Registrar & Transfer Agent (R&T) of the companies, Stock Exchange and its clearing house, Brokers and sub-brokers, Depository and depository Participants, etc.

Money market instruments

- Treasury bill
- Certificate of deposit
- Commercial papers
- Bill of exchange
- Call money/Notice money/Term money

Capital market instruments

- Global Depository Receipts (GDRs)
- American Depository Receipts (ADRs)
- Convertibles
- Foreign Currency Convertible Bonds (FCCBs)

Securities Exchange Board of India (SEBI)

SEBI was founded on April 12, 1992, under the SEBI Act, 1992. Headquartered in Mumbai, India, SEBI has regional offices in New Delhi, Chennai, Kolkata and Ahmedabad along with other local regional offices across prominent cities in India.

To put it simply, the primary reason for setting up SEBI was **to prevent malpractices in the capital market of India, to provide protection to the investors, to promote fair and proper function of capital market and promote the development of the capital markets.**

Government Securities Market

A government security (G-Sec) is a tradable instrument issued by the central government or state governments. In India, the central government issues both: treasury bills and bonds or dated securities, while state governments issue only bonds or dated securities, which are called the state development loans. Since they are issued by the government, they carry no risk of default, and hence, are called **risk-free gilt-edged instruments.**

Major players in the G-Secs. market include commercial banks and primary dealers (PDs) besides institutional investors like insurance companies. Other participants include co-operative banks, regional rural banks, mutual funds, provident and pension funds.

Govt. Security Market Instruments

- Treasury Bills (T-bills)
- Cash Management Bills (CMBs)
- Dated G-Secs

Sub Unit-6 Financial Institutions: Development Finance Institutions (DFIs); Non-Banking Financial Companies (NBFCs); Mutual Funds; Pension Funds

Development Financial Institutions (DFIs)

A development financial institution is intended to provide a necessary capital, enterprise, managerial and technical know-how as these are inadequate in developing economy like India. They also assist in building up the financial and socio-economic infrastructure, favourable to quick economic development.

Some development financial institution operating in India

- Industrial Development Bank of India (IDBI)
- Industrial Finance Corporation of India (IFCI)
- Industrial Credit and Investment Corporation of India (ICICI)
- Small Industries Development Bank of India (SIDBI)
- National Bank for Agriculture and Rural Development (NABARD)
- State Financial Corporation (SFCs)

Non-Banking Financial Companies (NBFCs)

As per RBI "A Non-Banking Financial Company (NBFC) is a company registered under the Companies Act, 1956 engaged in the business of loans and advances, acquisition of shares/stocks/bonds/debentures/securities issued by Government or local authority or other marketable securities of a like nature, leasing, hire-purchase, insurance business, chit business but does not include any institution whose principal business is that of agriculture activity, industrial activity, purchase or sale of any goods (other than securities) or providing any services and sale/purchase/construction of immovable property. A non-banking institution which is a company and has principal business of receiving deposits under any scheme or arrangement in one lump sum or in instalments by way of contributions or in any other manner, is also a non-banking financial company (Residuary non-banking company)."

A NBFC cannot accept public deposits by allowing people to open savings or current accounts with it. A NBFC also cannot issue cheques and drafts. Deposit insurance facility of Deposit Insurance and Credit Guarantee Corporation is not available to depositors of NBFCs, unlike in case of banks.

Types of NBFC

- Asset Finance Company (AFC) :
- Investment Company (IC)
- Loan Company (LC):
- Infrastructure Finance Company (IFC):
- Systemically Important Core Investment Company (CIC-ND-SI):
- Infrastructure Debt Fund:
- Non- Banking Financial Company (IDF-NBFC) :
- Non-Banking Financial Company – Factors (NBFC-Factors):

Mutual Funds

A mutual fund is an investment vehicle where many investors pool their money to earn returns on their capital over a period. This corpus of funds is managed by an investment professional known as a fund manager or portfolio manager. It is his/her job to invest the corpus in different securities such as bonds, stocks, gold and other assets and seek to provide potential returns. The gains (or losses) on the investment are shared collectively by the investors in proportion to their contribution to the fund.

What is Net Assets Value (NAV)?

It is the actual value of the investments made by the mutual fund for each unit issued by it. Net Asset Value (NAV) is the market value of a mutual fund unit. The overall cost of a mutual fund depends on this market value per fund unit.

Net Assets Value (NAV)=

$$\frac{Value\ of\ investment + Receivables + Accrued\ Income + Other\ Current\ Assets - \text{Liabilities} - \text{Accrued Expenses}}{No.of\ Outstanding\ Unit}$$

Structure of Mutual Funds

In India, the following entities are involved in a mutual fund operation: The Sponsor of the mutual fund, the Trustees, the Assets Management Company (AMC), the Custodian and the Registrar and Transfer Agent (R& T).

Types of Mutual Funds

- Equity/Stock Fund
- Debt Fund
- Balanced Fund
- Money Market Fund
- Open ended fund
- Close ended fund
- Interval Funds
- Growth Fund
- Income Fund
- Tax Savings Fund
- Capital Protection Fund
- Pension Fund
- Sector Funds
- Index Funds
- Real Estate Funds

7.6.4 Pension Funds

A pension fund, also known as a superannuation fund in some countries, is any plan, fund, or scheme that provides retirement income. Pension funds are pooled monetary contributions from pension plans set up by employers, unions, or other organizations to provide for their employees' or members' retirement benefits.

Types of Pension Funds in India

- Employee’s Provident Fund (EPF)
- Employees’ Pension Scheme (EPS)
- Employees Deposit Linked Insurance scheme (EDLI)
- Voluntary Provident Fund
- Public Provident Fund (PPF)

Sub Unit -7 Financial Regulators in India

There are many financial institutions in India and we have many regulators for regulating them in order to assure the proper functioning of the financial system in our nation. There are five regulatory bodies in financial sector.

- Reserve Bank of India (RBI)
- Securities Exchange Board of India (SEBI)
- Insurance Regulatory and Development Authority of India (IRDA)
- Forward Market Commission of India (FMC)
- Pension Fund Regulatory and Development Authority (PFRDA)

Sub Unit-8 Financial sector reforms including financial inclusion

Financial sector reforms

Financial sector reforms includes the following sector reforms-

- Banking Sector Reforms
- Capital Market Reforms
- FOREX market reforms
- Other Financial Sectors Reforms

  Non-banking financial companies (NBFCs) including those involved in public deposit taking activities, have been brought under the supervision of the RBI.

  Development finance institutions (DFIs), NBFCs, urban cooperative banks, specialised term-lending institutions and primary dealers- all of these have been brought under the regulation of the Board for Financial Supervision.

  Insurance Regulatory and Development Agency (IRDA) was established to control and overall development of insurance business.

Financial inclusion is the set of measures put in place to combat banking and financial exclusion. Financial Inclusion is described as the method of offering banking and financial solutions and services to every individual in the society without any form of discrimination. It primarily aims to include everybody in the society by giving them basic financial services without looking at a person's income or savings. Financial inclusion chiefly focuses on providing reliable financial solutions to the economically underprivileged sections of the society without having any unfair treatment. It intends to provide financial solutions without any signs of inequality. It is also committed to being transparent while offering financial assistance without any hidden transactions or costs.

Financial Inclusion Schemes in India

- Pradhan Mantri Jan Dhan Yojana (PMJDY)
- Atal Pension Yojana (APY)
- Pradhan Mantri Vava Vandana Yojana (PMVVY)
- Pradhan Mantri Mudra Yojana (PMMY)
- Pradhan Mantri Suraksha Bima Yojana (PMSBY)
- Sukanya Samridhi Yojana
- Jeevan Suraksha Bandhan Yojana
- Credit Enhancement Guarantee Scheme (CEGS) for Scheduled Castes (SCs)
- Venture Capital Fund for Scheduled Castes under the Social Sector Initiatives
- Varishtha Pension Bima Yojana (VPBY)

Sub Unit-9 Digitization of banking and other financial services: Internet banking; mobile banking; Digital payments systems

E- Banking

Electronic banking is defined as the automated delivery of new and traditional banking products and services directly to customers through electronic, interactive communication channels. 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.

Electronic banking can also be defined as a variety of the following platforms.

- Internet banking or online banking
- Telephone banking
- TV based banking
- Mobile phone banking

E- Banking Products and Services

- Internet Banking
- Mobile Banking
- Tele phone Banking
- Automated Teller machines (ATMs)
- Smart Card
- Debit Card
- Credit Card
- E-cheque
- E-wallet
- **Unified Payments Interface** (UPI)
- Electronic Clearing System (ECS)
- Electronic Fund Transfer
    - Real Time Gross Settlement (RTGS)
    - National Electronic Funds Transfer (NEFT)
    - **Immediate Payment Service (IMPS)**

Core Banking Solution (CBS)

It is a networking of bank branches, which allows customers to manage their accounts, and use various banking facilities from any part of the world. In simple term, there is no need to visit your own branch to do banking transactions. You can do it from any location, any time. You can enjoy banking services from any branch of the bank which is on CBS network regardless of branch you have opened your account. For the bank which implements CBS, the customer becomes the bank’s customer instead of customer of particular branch. In Core banking, the all branches access banking applications from centralized server which is hosted in secured data center.

Sub Unit-10: Insurance: Types of insurance- Life and Non-life insurance; Risk classification and management; Factors limiting the insurability of risk; Re-insurance; Regulatory framework of insurance- IRDA and its role

Concept of Insurance

Insurance is a legal contract between two parties –individual or entity who receives financial protection (referred to as insured) and the insurance company that promises to compensate the losses (referred to as insurer) in return for the money (premium) paid by the insured. In simple words, insurance provides protection. Basically, the concept of insurance is to spread the risk of an individual or an entity among larger society. Insurance is a risk management mechanism wherein you transfer your risk to the insurance company by paying them the premium.

Types of Insurance

Insurance can be broadly be classified as life insurance and general insurance. Life Insurance again can be classified as Term Insurance Plan, endowment plans, Pension Plan, Whole life insurance plan and Unit Linked Insurance Plan (ULIP), Child Plan. On the other hands general insurance can be classified as Motor Insurance, Health Insurance, Travel Insurance, Marine Insurance, Home Insurance, Fire Insurance, etc.

Regulatory framework of Insurance

Insurance Regulatory and Development Authority of India Act was passed by the Parliament in the year December 1999. The Act received President’s approval in the year January 2000. The Act intends to protect the interest of the insurance policy holders. It also aims to encourage and ensure the systematic growth of the insurance industry. The Insurance Regulatory and Development Authority is a statutory body formed by the Insurance Regulatory and Development Authority of India Act, 1999.

SECTION – 2: KEY STATEMENTS

Every candidates appearing for NET/SET examination should follow these key (main) points those can help them a better understanding regarding this unit very quickly.

Basic Key Statements: Financial system (7.1.1), Commercial bank (7.2.1.1), Public sector bank (7.2.1.1), Private sector bank (7.2.1.1), Foreign Banks (7.2.1.1), Monetary Policy (7.3.4), Financial Market (7.5.1), Money Market (7.5.1), Primary Market (7.5.1), Secondary Market (7.5.1), Non-Banking Financial Companies (7.6.2), Types of NBFC (7.6.2.2), Mutual Funds (7.6.3), Net Assets Value (NAV) (7.6.3.2), Assets Management Company (AMC) (7.6.3.3), Growth Fund (7.6.3.5), Income Fund(7.6.3.5), Reinsurance (7.10.1.1),Reinsurance(7.10.1.1),DoubleInsurance(7.10.1.1),UnderInsurance(7.10.1.1),Over Insurance(7.10.1.1), Revival Period (7.10.1.1), Free-look Period (7.10.1.1), Sum insured/Sum Assured (7.10.1.1), Home Insurance (7.10.1.2).

Standard Key Statements: Components of financial system (7.1.2), Nationalisation of bank(7.2.1.1), Small finance banks (7.2.1.2), Payments banks (7.2.1.3), Co-operative bank (7.2.1.4), Open market operation (7.3.4.3), Interest rate adjustment (7.3.4.3), Change Reserve requirement (7.3.4.3), Merchant banking (7.3.5), Investment Banking (7.3.5), Unit Banking/Localized banking(7.3.5), Relationship banking(7.3.5), Money market instruments(7.5.1.2), Global Depository Receipts(7.5.1.3), Convertibles(7.5.1.3), American Depository Receipts(7.5.1.3), Index Funds(7.6.3.5),Sector Funds (7.6.3.5).

Advanced Key Statements: Expansionary monetary policy (7.3.4.2), Contractionary monetary policy (7.3.4.2), Basel Norms (7.4.3), Types of Risk (7.4.4.1), Risk management strategies (7.4.4.2), Non- performing assets (7.4.5), Types of NPAs (7.4.5.1), risk-free gilt-edged instruments (7.5.4), Govt. Security Market Instruments (7.5.4.5), Financial Inclusion (7.8.2), E- Banking(7.9.1), E-cheque(7.9.1.1), Electronic Clearing System(7.9.1.1), Real Time Gross Settlement(7.9.1.1), National Electronic Funds Transfer(7.9.1.1), **Immediate Payment Service(7.9.1.1),** Core Banking Solution(7.9.1.2).

[N.B. – Values in parenthesis are the reference number]

SECTION – 3: KEY FACTS AND FIGURES

Sub Unit 1: Overview of Indian financial system

Sl. No.	Topics
1	7.1.1 Overview of Indian Financial system
2	7.1.2 Components of Indian Financial System
3	7.1.3 Functions of Indian Financial system

7.1.1 Overview of Indian Financial system

The financial system refers to set of complex and interconnected components consisting financial institutions, financial markets, financial instruments, financial regulators and financial services. The aim of the financial system is to facilitate the circulation of funds in an economy. Financial system helps in movement of funds from surplus unit to deficit spending unit. Financial system can be defined as "the integrated form financial institutions, financial markets, financial securities, and financial services which aim to circulate the funds in an economy for economic growth".

7.1.2 Components of Indian financial system

There are five components of Indian Financial system namely, Financial institutions, financial markets, financial assets or instruments or securities, financial services and financial regulators.

7.1.3 Functions of Indian Financial system

- The financial system helps in optimal allocation of financial resources in an economy.
- It helps in establishing a link between savers and investors.
- The financial system allows 'asset-liability change'. When they accept deposits from customers, banks make claims against themselves, but they also make assets when providing loans to customers.
- Economic resources (i.e., money) are transferred from one party to another through the financial system.
- The financial system ensures the efficient functioning of the payment mechanism in the economy. All transactions between buyers and sellers of goods and services are easily affected due to the financial system.
- In the case of mutual funds, the financial system helps in risk change by diversification.
- The financial system increases the liquidity of financial claims.
- The financial system helps in finding the prices of financial assets from the contact of buyers and sellers. For example, the value of the securities is determined by capital market demand and supply forces.
- The financial system helps reduce the cost of transactions.

Sub Unit: 2 Types of banks: Commercial banks; Regional Rural Banks (RRBs); Foreign banks; Cooperative banks

Sl. No	Topics
4	7.2.1 Types of Banks
5	7.2.1.1 Commercial Banks
6	7.2.1.2. Small Finance Banks
7	7.2.1.3 Payments Banks
8	7.2.1.4 Cooperative Banks
9	7.2.2 Functions of commercial banks

7.2.1 Types of Banks

Banks can be broadly be classified as Commercial Banks, Small Finance bank, Payment Banks and Co-Operative Bank

7.2.1.1. Commercial Banks

Commercial Bank can be described as a financial institution that offers basic investment products like a savings account, current account, etc. to the individuals and corporates. Along with that, it provides a range of financial services to the general public such as accepting deposits, granting loans and advances to the customers. It is a profit making company, which pays interest at a low rate to the depositors and charges higher rate of interest to the borrowers and in this way, the bank earns the profit.

Structure of commercial banks

Commercial banks are classified into two categories i.e. **scheduled commercial banks** and **non-scheduled commercial banks.**

A) Schedule Commercial 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. As per market capitalisation on June, 2020 HDFC Bank rank first and State bank of India rank second in India. In case of Private sector banks HDFC rank first as per market capitalisation and SBI rank first in case of public sector banks as per market capitalisation.

I) Public Sector Banks

When the Government holds more than 51% of the share capital of a publicly listed banking company, then that bank is called as Public sector bank.

i) SBI and its subsidiaries banks

State Bank of India (SBI) is the country's largest commercial bank in terms of assets, deposit and employees. It is a government –owned corporation which offers a wide range of general banking services from loans and advances to corporates and individuals in India and abroad. All subsidiary banks of SBI and Bhartiya Mahila Bank have been merged into SBI in April 2017.

ii) Nationalised Banks

In 1955, Imperial Bank of India was nationalised and was given the name State Bank of India. On 19th July, 1969, major 14 Indian commercial banks were nationalised. In 1980, another 6 banks were nationalised. Till the year 1980, approximately 80% of the banking segment in India was under government's ownership.

Objectives of Nationalisation of Banks

- To mobilise savings of the people to the maximum possible extent and utilise them for productive purposes;
- To meet the legitimate credit needs of private sector industry and trade (big or small);
- To counter the menace of money lenders;
- To bring about development and financial inclusion in rural areas to benefit farmers and other small scale/cottage industries;
- To increase the reach of bank towards rural areas i.e. to counter the urban bias;

- To make the banking industry tilt towards social purpose instead of profit making org. as was the trend then;
- To check (stop) the use of the bank credit for speculative and other unproductive purposes.

iii) Regional Rural Banks

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 labourers, and small entrepreneurs. NABARD holds the apex position in the agricultural and rural development. For examples Assam Gramin Vikash Bank, Bangiya Gramin Vikash Bank, Karnataka Gramin Bank etc.

II) **Private Sector Banks**

When the private individuals own more than 51% of the share capital, then that banking company is a private one. However, these banks are publicly listed companies in a recognized exchange.

Name of Some Private Sector Banks operating in India

Axis Bank, ICICI Bank, Kotak Mahindra Bank, Indusind Bank, IDFC Bank, DCB Bank, Federal Bank, Bandhan Bank, Yes Bank etc.

III) **Foreign Sector Banks**

Banks set up in foreign countries, and operate their branches in the home country are called as foreign banks.

Name of Some Foreign Sector Banks operating in India

Hong Kong and Shanghai Banking Corporation (HSBC),
Citibank,
American Express Bank,
Standard Chartered Bank,
DBS Bank

B) Non- schedule Commercial 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. They work on the lines of a cooperative society and help people in need with mutual aspirations. A few local area banks are: **Coastal Local Area Bank Ltd (Vijayawada), Capital Local Area Bank Ltd (Phagwara), Subhadra Local Area Bank Ltd (Kolhapur)**, Krishna Bhima Samruddhi Local Area Bank Ltd

7.2.1.2. Small Finance Banks

This is a niche banking segment in the country and is aimed to provide financial inclusion to sections of the society that are not served by other banks. The main customers of small finance banks include micro industries, small and marginal farmers, unorganized sector entities and small business units. These are licensed under Section 22 of the Banking Regulation Act, 1949 and are governed by the provisions of RBI Act, 1934 and FEMA.

Name of Small Finance Banks

Ujjivan Small Finance Bank Ltd., Jana Small Finance Bank Ltd., AU Small Finance Bank Ltd., Capital Small Finance Bank Ltd., etc.

7.2.1.3 Payments Banks

A payments bank is like any other bank, but operating on a smaller scale without involving any credit risk. In simple words, it can carry out most banking operations but can't advance loans or issue credit cards. It can accept demand deposits (up to Rs 1 lakh), offer remittance services, mobile payments/transfers/purchases and other banking services like ATM/debit cards, net banking and third party fund transfers.

Name of Payments Banks

Airtel Payments Bank, India Post Payments Bank, Fino Payments Bank, Paytm Payments Bank.

7.2.1.4 Cooperative Banks

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 organisation of non-credit societies. Co-operative banks can be of following two types-

i) Central co-operative Banks

ii) State Co-operative Banks

7.2.2 Functions of commercial banks

Accepting Deposits:

The primary function of the commercial bank is **to accept deposits from the general public,** who possess surplus funds and are willing to deposit them so as to earn interest on it. Generally in a commercial bank four types of account can be opened by an individual or corporate house savings account, current account, fixed deposit and recurring deposit.

Advancing Loans:

Next important function performed by the commercial bank is lending money to the individuals and companies. The banks make loans to the customers in the form of term loans, cash credit, overdraft and discounting of bills of exchange.

Agency Services: There are some facilities provided by the commercial banks in which they act as an agent of the customers. Such services are:

- Collection and payment of rent, interest and dividend.
- Collection and payment of cheques and bills.
- Buying and selling securities.
- Payment of insurance premium and subscriptions.

General Utility Services:

Commercial banks provide general utility services to the customers and charge a fee for the same. It covers services like:

- Safekeeping of valuables, documents etc., in locker or vault.
- ATM card, credit card and debit card facility.
- Issue of demand draft, pay order and travellers cheque.
- Internet and mobile banking
- Sale of application forms of competitive exams.

Transfer of funds: Banks assist in the transfer of funds from one person to another or from one place to another through its credit instruments.

Credit Creation: The commercial banks are authorized to create credit, by granting more loans than the amounts deposited by the customers.

Previous Year Question

Sub Unit – 7.2

July- 2018

1. Interest earned by a depositor against a deposit with a commercial bank for custodial service:

A. is a fund based income
B. is a fee based income
C. is a combination of fund and fee based gain
D. is a commitment based gain

Answer with Reference

SL. NO	ANSWER	REFERENCE NO.
1.	A	7.2.1.1

Dec. 2015

1. Select the major principles which banks strive to incorporate in their working from the following:
(a) Profitability
(b) Labour welfare
(c) Social welfare
(d) Safety
(e) HRD
(f) Liquidity
A. (a), (b), (d), (e)
B. (a), (c), (d), (f)
C. (c), (d), (e), (f)
D. (a), (b), (c), (d)

2.Identify the years in which different phases of Bank Nationalisation took place in India:
(a) 1950 (b) 1955 (e) 1969 (d) 1949 (e) 1980
A (a), (b), (e), (d)
B. (b), (c), (e)
C. (b), (d), (e)
D. (c), (d), (e)

Answer with Reference

SL. NO	ANSWER	REFERENCE NO.
1.	B	7.2.1.1
2.	B	7.2.1.1

Sub Unit: 3 Reserve Bank of India: Functions; Role and monetary policy management

Sl. No	Topics
10	7.3.1 Organisations and Management of RBI
11	7.3.2 Objectives of RBI
12	7.3.3 Functions of RBI
13	7.3.4 Monetary Policy Management
14	7.3.4.1 Objectives of Monetary Policy
15	7.3.4.2 Expansionary vs. contractionary monetary policy
16	7.3.4.3 Tools of monetary policy
17	7.3.5 Types of banking System

7.3.1 Organisations and Management of RBI

The Reserve Bank of India (RBI) was established on April 1, 1935, in accordance with the Reserve Bank of India Act, 1934. The Reserve Bank is permanently situated in Mumbai since 1937. The Reserve Bank is fully owned and operated by the Government of India. The Reserve Bank of India was originally established as a shareholders' bank with a share capital of Rs.5 crores, divided into 5 lakhs fully paid-up shares of Rs.100 each. When the bank was nationalized in 1949, the entire share capital was acquired by the Central Government by compensating the shareholders.

The Reserve Bank's operations are governed by a central board of directors; RBI is on the whole operated with a 21-member central board of directors appointed by the Government of India in accordance with the Reserve Bank of India Act.

The Central board of directors comprise of:

- Official Directors – The governor who is appointed/nominated for a period of four years along with four Deputy Governors
- Non-Official Directors – Ten Directors from various fields and two government Official

Organisation structure of RBI is as follows

7.3.2 Objectives of RBI

The Preamble of the Reserve Bank of India describes the basic objectives of the Reserve Bank as:

- Regulating the issue of Banknotes
- Securing monetary stability in India
- Modernising the monetary policy framework to meet economic challenges

7.3.3 Functions of RBI

Monetary Authority

- Formulating and implementing the national monetary policy.
- Maintaining price stability across all sectors while also keeping the objective of growth.

Regulatory and Supervisory

- Set parameters for banks and financial operations within which banking and financial systems function.
- Protect investors' interest and provide economic and cost-effective banking to the public.

Foreign Exchange Management

- Oversees the Foreign Exchange Management Act, 1999.
- Facilitate external trade and development of foreign exchange market in India.

Issue of Notes

The Reserve Bank has a monopoly for printing the currency notes in the country. It has the sole right to issue currency notes of various denominations except one rupee note (which is issued by the Ministry of Finance).

Developmental role

Promotes and performs promotional functions to support national banking and financial objectives.

Banker to Government:

As banker to the government the Reserve Bank manages the banking needs of the government. It has to-maintain and operate the government's deposit accounts. It collects receipts of funds and makes payments on behalf of the government. It represents the Government of India as the member of the IMF and the World Bank.

Banker's Bank

The Reserve Bank performs the same functions for the other commercial banks as the other banks ordinarily perform for their customers. RBI lends money to all the commercial banks of the country.

Controller of the Credit

The RBI undertakes the responsibility of controlling credit created by commercial banks. RBI uses two methods to control the extra flow of money in the economy. These methods are quantitative and qualitative techniques to control and regulate the credit flow in the country. **When RBI observes that the economy has sufficient money supply and it may cause an inflationary situation in the country then it squeezes the money supply through its tight** monetary policy **and vice versa.**

Credit Control Mechanism adopted by the RBI

Credit control mechanism of RBI can broadly be classified into

a) Quantitative credit control mechanism

In India, the legal framework of RBI's control over the credit structure has been provided Under Reserve Bank of India Act, 1934 and the Banking Regulation Act, 1949. Quantitative credit controls are used to maintain proper quantity of credit of money supply in market. Some of the important general credit control methods are

1. Bank Rate Policy

Bank rate is the rate at which the Central bank lends money to the commercial banks for their liquidity requirements. Bank rate is also called discount rate. In other words bank rate is the rate at which the central bank rediscounts eligible papers (like approved securities, bills of exchange, commercial papers etc) held by commercial banks. Bank rate is important because it is the pace setter to other market rates of interest. Bank rates have been changed several times by RBI to control inflation and recession.

2. **Open market operations**

It refers to buying and selling of government securities in open market in order to expand or contract the amount of money in the banking system. This technique is superior to bank rate policy. Purchases inject money into the banking system while sale of securities do the opposite. During last two decades the RBI has been undertaking switch operations. These involve the purchase of one loan against the sale of another or, vice-versa. This policy aims at preventing unrestricted increase in liquidity.

3. **Cash Reserve Ratio (CRR)**

The Cash Reserve Ratio (CRR) is an effective instrument of credit control. Under the RBl Act of, l934 every commercial bank has to keep certain minimum cash reserves with RBI. The RBI is empowered to vary the CRR between 3% and 15%. A high CRR reduces the cash for lending and a low CRR increases the cash for lending.

4. **Statutory Liquidity Ratio (SLR)**

Under SLR, the government has imposed an obligation on the banks to; maintain a certain ratio to its total deposits with RBI in the form of liquid assets like cash, gold and other securities. The RBI has power to fix SLR in the range of 25% and 40% between 1990 and 1992 SLR was as high as 38.5%. Narasimham Committee did not favour maintenance of high SLR.

5.Repo and Reverse Repo Rates

In determining interest rate trends, the repo and reverse repo rates are becoming important. Repo means Sale and Repurchase Agreement. Repo is a swap deal involving the immediate Sale of Securities and simultaneous purchase of those securities at a future date, at a predetermined price. Repo rate helps commercial banks to acquire funds from RBI by selling securities and also agreeing to repurchase at a later date.

Reverse repo rate is the rate that banks get from RBI for parking their short term excess funds with RBI. Repo and reverse repo operations are used by RBI in its Liquidity Adjustment Facility. RBI contracts credit by increasing the repo and reverse repo rates and by decreasing them it expands credit.

b) Selective credit control mechanism

Under Selective Credit Control, credit is provided to selected borrowers for selected purpose, depending upon the use to which the control tries to regulate the quality of credit - the direction towards the credit flows. The Selective Controls are

1. Ceiling on Credit

The Ceiling on level of credit restricts the lending capacity of a bank to grant advances against certain controlled securities.

2. Margin Requirements

A loan is sanctioned against Collateral Security. Margin means that proportion of the value of security against which loan is not given. Margin against a particular security is reduced or increased in order to encourage or to discourage the flow of credit to a particular sector. It varies from 20% to 80%. For agricultural commodities it is as high as 75%. Higher the margin lesser will be the loan sanctioned.

3. Discriminatory Interest Rate (DIR)

Through DIR, RBI makes credit flow to certain priority or weaker sectors by charging concessional rates of interest. RBI issues supplementary instructions regarding granting of additional credit against sensitive commodities, issue of guarantees, making advances etc.

4. Directives

The RBI issues directives to banks regarding advances. Directives are regarding the purpose for which loans may or may not be given.

5. Direct Action

It is too severe and is therefore rarely followed. It may involve refusal by RBI to rediscount bills or cancellation of license, if the bank has failed to comply with the directives of RBI.

6. Moral Suasion

Under Moral Suasion, RBI issues periodical letters to bank to exercise control over credit in general or advances against particular commodities. Periodic discussions are held with authorities of commercial banks in this respect.

7. **Credit Rationing**

The **Credit Rationing** is a measure undertaken by the central bank to limit or deny the supply of credit based on the investor's creditworthiness and an increased loan demand.

7.3.4 Monetary Policy Management

Monetary policy is an economic policy that manages the size and growth rate of the money supply in an economy. Monetary policy is the macroeconomic policy laid down by the central bank. It involves management of money supply and interest rate and is the demand side economic policy used by the government of a country to achieve macroeconomic objectives like inflation, unemployment, consumption, growth and liquidity. Monetary policy aims at influencing the economic activity in the economy mainly through two major variables, i.e., **(a) money or credit supply, and (b) the rate of interest**. In India, monetary policy of the Reserve Bank of India is aimed at managing the quantity of money in order to meet the requirements of different sectors of the economy and to increase the pace of economic growth.

7.3.4.1 Objectives of Monetary Policy

The main objectives of monetary policy are to manage the inflation, to reduce unemployment and manage currency exchange rate. To manage inflation RBI reduce the money supply by restricting the volume of money banks can lend. The banks charge a higher interest rate, making loans more expensive. Fewer businesses and individuals borrow, slowing growth. To reduce unemployment Central banks use expansionary monetary policy or increase the money supply to lower unemployment and avoid recession. To manage exchange rate central bank may take suitable monetary measures by issuing more currency or reducing currency supply in the market.

7.3.4.2 Expansionary vs. contractionary monetary policy

In **Expansionary** monetary policy central bank increase the money supply by reducing interest rate, lower the reserve requirement of the banks and purchase government securities.

On the other hand in case of **Contractionary** monetary policy central bank reduce the money supply in the market by increasing interest rate, selling government bonds and increasing reserve requirement of the banks.

7.3.4.3 Tools of monetary policy

Central banks use the following tools to implement the monetary policy measures-

Interest rate adjustment: A central bank can influence interest rates by changing the discount rate. The discount rate (base rate) is an interest rate charged by a central bank to banks for short-term loans. For example, if a central bank increases the discount rate, the cost of borrowing for the banks increases. Subsequently, the banks will increase the interest rate they charge their customers. Thus, the cost of borrowing in the economy will increase, and the money supply will decrease.

Change Reserve requirement- Central banks usually set up the minimum amount of reserves that must be held by a commercial bank. By changing the required amount, the central bank can influence the money supply in the economy. If monetary authorities increase the required reserve amount, commercial banks find less money available to lend to their clients and thus, money supply decreases.

Open market operation- In open market operation strategy the central bank can either purchase or sell securities issued by the government to affect the money supply.

Demonetisation refers to the process of removing or stripping the legal status of a currency.

7.3.5 Types of banking System

i) Branch Banking

The Banking system of England originally offered an example of the branch banking system, where each commercial bank has a network of branches spread throughout the country. So, branch banking can be defined as the provision of banking services through the different branches.

ii) Unit Banking/Localized banking

Unit banking is originated and developed in the U.S.A. In this system, small independent banks are functioning in a limited area or in a single town. In Unit banking, services is given by an institution without any branch. It has its own board of directors and stockholders. It is also called as “localized Banking”.

iii) Group banking

Group Banking is the system in which two or more independently incorporated banks are brought under the control of a holding company. The holding company may or may not be a banking company. Under group banking, the individual banks may be unit banks, or banks operating branches or a combination of the two.

iv) Corresponding banking

The correspondent banking system is developed to remove the difficulties in the unit banking system. The smaller banks deposit their cash reserve with bigger banks. Therefore, correspondent banks are intermediaries through which all unit banks are linked with bigger banks in financial centres. Through correspondent banking, a bank can carry-out business transactions in another place where it does not have a branch.

v) Investment Banking

Investment banking is a special segment of banking operation that helps individuals or organisations raise capital and provide financial consultancy services to them.

vi) Offshore Banking

The offshore banking refers to the deposit of funds by a company or an individual in a bank that is located outside their national residence. Although the term implies that these banks are located on islands, many offshore banks are found in Cayman Islands, Bermuda, Luxembourg, the Channel Islands, Macau and Panama. The advantage of offshore banking is that funds are tax exempt, where the banks are located.

vii) Narrow Banking

A bank may be concentrating only on the collection of deposits and lend or invest the money within a particular region or certain chosen activity like investing the funds only in Government Securities. This type of restricted minimum banking activity is referred to as ‘Narrow Banking’.

viii) Universal Banking

As Narrow Banking refers to restricted and limited banking activity Universal Banking refers to broad-based and comprehensive banking activities.

ix) Merchant banking

Merchant banking can be defined as a skill-oriented professional service provided by merchant banks to their clients, concerning their financial needs, for adequate consideration, in the form of fee.

x) Relationship banking

It refers to the efforts of a bank to promote personal contacts and to keep continuous touch with customers who are very valuable to the bank. In order to retain such profitable accounts with the bank or to attract new accounts, it is necessary for the bank to serve their needs by maintaining a close relationship with such customers.

xi) Indigenous Banking

Indigenous banking is the provision of banking services (accepting deposit and giving loan) by individuals or private firms. There is a significant difference between money lenders and indigenous bank. A pure moneylender lends his own funds whereas an indigenous banker raises a part of his loanable funds from the public in deposits or other forms. A moneylender conducts his transactions in cash, while a large part of the transactions of an indigenous banker are based on dealings in short term credit instruments like hundis and commercial bills.

xii) Development banking

Development banks are those which have been set up mainly to provide infrastructure facilities for the industrial growth of the country. They provide financial assistance for both public and private sector industries.

Previous Year Question

Sub Unit – 7.3

June 2019

1. **Assertion (A):** Reserve Bank of India is an important regulatory and administrative authority to execute FEMA provisions.

Reason (R): Being monetary authority and custodian of foreign exchange, Reserve bank of India enjoys requisite expertise of FEMA administration.

In the context of the above two statements, which one of the following options is correct?

1. Both (A) and (R) are correct and (R) is the right explanation of (A)
2. Both (A) and (R) are correct but (R) is not the right explanation of (A)
3. Both (A) and (R) are incorrect
4. (A) is correct and (R) is not correct

Answer with Reference

SL. NO.	ANSWER	REFERENCE NO.
1.	1	7.3.1

July- 2018

1. **Assertion (A) :** The Reserve Bank of India is entrusted with the management of the public debt and issue of new loans and treasury bills on behalf of the central and state Governments.
Reasoning (R) : The Governor and the Deputy Governors of Reserve Bank of India are appointed by the Central Government.
Code :
(1) (A) is correct but (R) is not correct.
(2) (A) and (R) both are correct but (R) is not the right explanation of (A).
(3) (A) and (R) both are correct and (R) is the right explanation of (A).

2.**__________ refers to the process of removing or stripping the legal status of a currency.**

(1) Digitisation
(2) Financial Inclusion
(3) Demonetisation
(4) Micro finance

Answer with Reference

SL. NO.	ANSWER	REFERENCE NO.
1.	2	7.3.1
2.	3	7.3.4.3

Jan.- 2017

1.Match the items of Column-I with the items of Column-II and suggest the correct code.

Column – I	**Column – II**
a. Relationship Banking	i. Dealing in hundis and acceptance of deposits.
b. Merchant Banking	ii. Widening the entrepreneurial base and assist in a rapid rate of industrial growth.
c. Indigenous Banking	iii. Engaged in the business of Issue Management.
d. Development Banking	iv. Creating, maintaining and enhancing strong relationship with customers.

Codes :

	a	**b**	**c**	**d**
(1)	iv	ii	I	iii
(2)	ii	iv	iii	i
(3)	iv	iii	I	ii
(4)	ii	i	iv	iii

Answer with Reference

SL. NO.	ANSWER	REFERENCE NO.
1.	3	7.3.5

Sept. 2016

1. **Which combination of the following methods indicates quantitative methods of control of credit creation practiced by the Reserve Bank of India ?**

(a) Bank Rate
(b) Open Market Operations
(c) Variable Reserve Ratios
(d) Credit Rationing

Codes :

(1) (a), (b) and (c)
(2) (a), (b) and (d)
(3) (b), (c) and (d)
(4) (a), (c) and (d)

Answer with Reference

SL. NO.	ANSWER	REFERENCE NO.
1.	1	7.3.3

July 2016

1. **Which of the following methods are qualitative methods of control of credit creation practiced by the Reserve Bank of India ?**

(a) Open Market Operations
(b) Variable Reserve Ratios
(c) Credit Rationing
(d) Margin Requirements

Codes :

(1) (a) and (b)
(2) (b) and (c)
(3) (c) and (d)
(4) (d) and (a)

Answer with Reference

SL. NO.	ANSWER	REFERENCE NO.
1.	**3**	7.3.3

Dec. 2015

1. **Select the techniques of monetary control adopted by RBI from the following:**

(a) Cash Reserve Ratio
(b) Statutory Liquidity Ratio
(c) Bank Rate
(d) Currency Rate
a. (a), (b), (c), (d)
b. (b), (e), (d)
c. (a), (c), (d)
d. (a), (b), (c)

Answer with Reference

SL. NO.	ANSWER	REFERENCE NO.
1.	D	7.3.3

Sub Unit 4: Banking sector reforms in India: Basel norms; Risk management; NPA management

Sl. No	Topics
17	7.4.1 Banking sector reforms in India
18	7.4.2 Objectives of banking sector reforms in India
19	7.4.3 Basel Norms
20	7.4.4 Risk Management
21	7.4.4.1 Types of Risk in banking Sector
22	7.4.4.2 Risk management strategies
23	7.4.5 NPA Management
24	7.4.5.1 Types of NPAs
25	7.4.5.2 Provisioning Norms for NPA

7.4.1 Banking sector reforms in India

History of banking System in India can be discussed by classifying them into three distinct phases

1**. Pre- Independence Phase i.e. before 1947**

The origin of the Banking system in India can be traced with the foundation of Bank of Calcutta in 1786. The Banking in India originates in the last decade in the 18th century with the foundation of the English Agency houses in Bombay and Calcutta (now Kolkata).

- Three presidency banks **Bank of Bengal, Bank of Bombay** and **Bank of Madras** established in the 19th Century under the charter of the British East India Company.
- In 1935, the presidency banks merge together and formed a new bank named Imperial Bank of India.
- The Imperial Bank of India subsequently named the **State Bank of India.**
- The first Indian-owned Allahabad Bank was set up in 1865 in Allahabad.
- In 1895, the Punjab National Bank was established in 1895.
- The Bank of India founded in 1906 in Mumbai.
- Many more commercial banks such as Canara Bank, Indian Bank, Central Bank of India, Bank of Baroda and Bank of Mysore were established between 1906 and 1913under Indian ownership.
- The central Bank of India, RBI establish in 1935 on the recommendation of **Hilton-Young Commission.**

At that time, the Banking system was only covered the urban population and need of rural and agriculture sector was totally neglected.

2. Second Phase i.e. 1947-1991

At the time independence, the entire Banking sector was under private ownership. The rural population of the country had to dependent on small money lenders for their requirements. To solve these issues and better development of the economy the Government t of India nationalised the Reserve Bank of India in 1949.

- **In 1955** the **Imperial Bank of India** was nationalised and named the **State Bank of India.**
- The Banking Regulation Act enacted in 1949.
- In 1969, Government of India nationalised 14 major banks whose national deposits were more than 50 crores.
- Allahabad Bank
- Bank of India
- Punjab National Bank
- Bank of Baroda
- Bank of Maharashtra
- Central Bank of India
- Canara Bank
- Dena Bank
- Indian Overseas Bank
- Indian Bank
- United Bank
- Syndicate Bank

- Union Bank of India
- UCO Bank
- The Indian Banking system immensely developed after nationalisation but the rural and weaker section of the society was still not covered under the system.
- To solve these issues, the **Narasimham Committee** in 1974 recommended the establishment of **Regional Rural Banks (RRB)**. On **2nd October 1975, RRBs were established** with an objective to extend the amount of credit to the rural section of the society.
- **Six more banks** further nationalised in the year 1980. With the second wave of nationalisation, the target of priority sector lending was also raised to 40%.
- Andhra Bank
- Corporation Bank
- New Bank of India
- Oriental Bank of Commerce
- Punjab & Sindh Bank
- Vijaya Bank

3. **Third phase i.e. 1991 to till date**

- In order to improve financial stability and profitability of Public Sector Banks, the Government of India set up a committee under the chairmanship of **Shri. M. Narasimham**. The **committee recommended several measures to reform banking system in the country.**
- The major thrust of the recommendations was to make banks competitive and strong and conducive to the stability of the financial system.
- The committee suggested for no more nationalisation of banks.
- Foreign banks would be allowed to open offices in India either as branches or as subsidiaries.
- In order to make banks more competitive, the committee suggested that public sector banks and private sector banks should be treated equally by the Government and RBI.
- It was emphasised that banks should be encouraged to abandon the conservative and traditional system of banking and adopt progressive function such as merchant banking and underwriting, retail banking, etc.
- Now, foreign banks and Indian banks permitted to set up joint ventures in these and other newer forms of financial services.
- 10 Privates players got a license from the RBI to entry in the Banking sector. These were Global Trust Bank, ICICI Bank, HDFC Bank, Axis Bank, Bank of Punjab, IndusInd Bank, Centurion Bank, IDBI Bank, Times Bank and Development Credit Bank.
- The Government of India accepted all the major recommendation of the committee.
- In July 2001, the Centre had set up the committee to review RRBs operations under the chairmanship of Chalapathi Rao for the revival of regional rural banks
- Kotak Mahindra Bank and Yes Bank got a license from RBI to entry in the system in the year 2003 and 2004.
- In 2014, RBI grants in-principle approval to **IDFC** and **Bandhan Financial Services** to set up banks.

- In order to further financial inclusion, RBI also proposed to setup two new kinds of banks i.e. **Payments Bank and Small bank.**
- **In 2015** RBI gave in principle licence to 11 entities to launch **payments Bank** and granted in principle approval to the 10 applicants to set up **Small finance bank.**
- **In 2017 Finance minister** announced amalgamation of 10 public sector banks into four big banks. After this the total number of Public Sector Banks in the country will come down to 12 from 27 banks. announced that government has decided to merge Punjab National Bank, Oriental Bank of Commerce and United Bank; Canara Bank and Syndicate Banks; Union Bank of India, Andhra Bank and Corporation Bank; and Indian Bank and Allahabad Bank.
- **On 1st April, 2020** Oriental Bank of Commerce and United Bank of India merged into **Punjab National Bank**; Syndicate Bank into **Canara Bank**; Allahabad Bank into **Indian Bank**; and Andhra and Corporation banks into **Union Bank of India.**

7.4.2 Objectives of banking sector reforms in India:

- Reforms were aimed at bringing a transformation change in the structure, efficiency and stability of the banking system, and also integration with the international markets.
- To make Indian banks, internationally competitive and encourage them to play an effective role in accelerating the process of growth.
- The reforms in the banking sector in India intended to enhance the stability and efficiency of banks
- To remove the operational rigidities in the credit delivery system to ensure allocation efficiency and achievement of social objectives.
- To place the Indian banking system on par with international standards in respect of capital adequacy and other prudential norms.
- The strengthening measures aimed at reducing the vulnerability of banks in the face of fluctuations in the economic environment. These included capital adequacy, income recognition, asset classification, provisioning norms, exposure norms, improved levels of transparency, and disclosure standards.

7.4.3 Basel Norms

Basel is a city in Switzerland. It is the headquarters of Bureau of International Settlement (BIS), which fosters co-operation among central banks with a common goal of financial stability and common standards of banking regulations. Every two months BIS hosts a meeting of the governor and senior officials of central banks of member countries. 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. In fact, on a few parameters the RBI has prescribed stringent norms as compared to the norms prescribed by BCBS.

Capital Adequacy Norms

Capital adequacy reflects the Overall soundness of the individual bank and risk exposure of the individual bank. Along with the profitability and safety, banks also give importance to solvency. Solvency refers to the situation where assets are equal or more than liabilities. Basel committee was appointed by BIS formulated rules and regulation for effective supervision of the central banks. For this it, also prescribed international norms to be followed by the central banks. The committee prescribed Capital Adequacy Norms in order to protect the interest of the customers.

Capital Adequacy Ratio (CAR)

Capital Adequacy Ratio (CAR) is the ratio of a bank's capital in relation to its risk weighted assets and current liabilities. It is decided by central banks and bank regulators to prevent commercial banks from taking excess leverage and becoming insolvent in the process.

Capital Adequacy Ratio =

(Tier I + Tier II + Tier III (Capital funds)) /Risk weighted assets

The risk weighted assets take into account credit risk, market risk and operational risk. The Basel III norms stipulated a capital to risk weighted assets of 8%. However, as per RBI norms, Indian scheduled commercial banks are required to maintain a CAR of 9% while Indian public sector banks are emphasized to maintain a CAR of 12%.

Basel Norms-I

In 1988, BCBS introduced **capital measurement system called Basel capital accord**, also called as Basel 1. It focused almost entirely on **credit risk**. It defined capital and structure of risk weights for banks. The minimum capital requirement was fixed at 8% of risk weighted assets (RWA). RWA means assets with different risk profiles. For example, an asset backed by collateral would carry lesser risks as compared to personal loans, which have no collateral. India adopted Basel 1 guidelines in 1999.

Basel Norms-II

In June '04, 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 the committee calls it as pillars. –

Capital Adequacy Requirements: Banks should maintain a minimum capital adequacy requirement of 8% of risk assets. 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.

Supervisory Review: According to this, banks were needed to develop and use better risk management techniques in monitoring and managing all the three types of risks that a bank faces, viz. credit, market and operational risks.

Market Discipline: This need increased disclosure requirements. Banks need to mandatorily disclose their CAR, risk exposure, etc to the central bank. Basel II norms in India and overseas are yet to be fully implemented.

Basel Norms-III

Basel III is an international regulatory accord that introduced a set of reforms designed to **improve the regulation, supervision, and risk management within the banking sector**. Basel III is an iterative step in the on-going effort **to enhance the banking regulatory framework**. In 2010, Basel III guidelines were released. These guidelines were introduced **in**

response to the financial crisis of 2008. A need was felt to further strengthen the system as banks in the developed economies were under-capitalized, over-leveraged and had a greater reliance on short-term funding. Also the quantity and quality of capital under Basel II were deemed insufficient to contain any further risk. Basel III norms aim at making most banking activities such as their trading book activities more capital-intensive. The guidelines aim to promote a more resilient banking system by focusing on four vital banking parameters viz. **capital, leverage, funding and liquidity.**

Three pillars of BASEL III norms

Pillar 1 : Minimum Regulatory Capital Requirements based on Risk Weighted Assets (RWAs) : Maintaining capital calculated through credit, market and operational risk areas.

Pillar 2 : Supervisory Review Process : Regulating tools and frameworks for dealing with peripheral risks that banks face.

Pillar 3: Market Discipline : Increasing the disclosures that banks must provide to increase the transparency of banks

7.4.4 Risk Management

What is risk?

A risk in banks can be defined as the uncertainty in future income.

7.4.4.1 Types of Risk in banking Sector

Credit Risk: It is also called default risk. It is the risk associated with default made by the borrower in repaying the money back as per agreement.

Market Risk: It is the risk associated with loss arises due to investment in equity market as well as fluctuation in interest rate. So, fall in the share price of a company or fall in the share price of other company in which company has invested is called market risk. Market risk is considered as systematic risk as it is uncontrollable to the banks and is caused by the external factors.

Liquidity Risk:

Non-payment of the credit by the borrowers results in reduction of the credit capacity of the bank. Due to absence of sufficient liquidity (cash inflow) banks are unable to provide the loan to the genuine customers. This risk is known as liquidity risk.

Operational Risk: As per Basel II operational risk means "the risk of loss resulting from inadequate or failed internal processes, people and systems or from external events". So the risk arises due to failure in core banking solution or failure of internal processes is called operational risk.

Reputation Risk:

It is the risk arises due to negative public opinion towards the banks due to fraud or scam and inability of the bank to control operation risk. Non-payment of loan, rising of NPA and large debt may create negative image towards the bank.

Systematic Risk:

The risk caused by the external factors and which is beyond the control of the bank such as management, the strike of the employee, market fluctuation, non-stability of the government, fraud in the bank, etc. So it is a risk which is unpredictable and cannot be completely avoided.

7.4.4.2 Risk management strategies

Risk Identification

Risk identification is the process of determining risks that could potentially prevent the enterprise from achieving its objectives. It includes documenting and communicating the concern. Risk identification is the critical first step of the risk management process.

Risk Analysis

Risk analysis is the process of assessing the likelihood of an adverse event occurring within the corporate, government, or environmental sector. So, risk analysis attempts to estimate the extent of the impact that will be made if the event happens.

Risk Reduction

It refers to the way an insurance company can reduce its financial losses by implementing measures that will prevent actualizing risks or minimizing the number that can actually happen. For example, an insurance company may also ask an employer whose business it covers to upgrade the safety standards in their workplace or on their job sites. Safety measures that prevent employees from suffering serious injury will save the insurer from financial losses incurred through liability coverage.

Risk sharing

It is the process of distributing the risk among the several project participants or departments.

Risk Retaining

Risk retention is a company's decision to take responsibility for a particular risk it faces, as opposed to transferring the risk over to an insurance company. Companies often retain risks when they believe that the cost of doing so is less than the cost of fully or partially insuring against it.

Risk Monitoring

Risk monitoring is the process of follow up the existing risk and overall risk management policies of the concern continuously. It is also concerned with the identifying the new risk that may generate in future.

Risk Transfer

In Risk Transfer approach, the risk is shifted to a third party. The third-party, like insurance company or vendor, is paid to accept or handle the risk on your behalf and hence the ownership, as well as impact of the risk, is borne by that third party. This payment is called a risk premium. Contracts are signed to transfer the liability of risks to the third party.
Risk Transfer does not eliminate the risk, but it reduces the direct impact of the risk on the project.

7.4.5 NPA Management

What is Non-Performing assets?

When an individual fails to repay or return the money borrowed from a lender, then such kind of a loan becomes nonperforming in the books of financial institutions. There is no guarantee whether a lender can receive the money lent to the borrower. It is those assets which cease to generate any return to the bank. A non -performing asset (NPA) is a classification used by the financial institution for loan or advance on which the principal is past due and no interest payment have been made for a period of 90 days or more.

As per RBI guidelines a Non-Performing Asset (NPA) is a loan or an advance where:

(i) Interest and/or instalment of principal remain overdue for a period of more than 90 days in respect of a term loan.
(ii) The account remains 'out of order' in respect of an Overdraft/Cash Credit (OD/CC) for more than 90 days.
(iii) The bill remains overdue for a period of more than 90 days in the case of bills purchased and discounted.
(iv) For agricultural crop loans, the instalment of principal or interest thereon remains overdue for two crop seasons for short-duration crops.
(v) The instalment of principal or interest thereon remains overdue for one crop season for long duration crops under agricultural loan.
Banks should classify an account as NPA only if the interest charged during any quarter is not serviced fully within 90 days from the end of the quarter.

7.4.5.1 Types of NPAs

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

Standard assets: These are the assets which continue to generate income and repayments as and when they fall due without any default or risk. Such assets carry a normal risk and are not NPA in real sense.

Substandard: A sub-standard asset would be one that has remained NPA for a period less than or equal to 12 months. In such cases, 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.

Doubtful Debts: An asset would be classified as doubtful if it has remained in the substandard category for a period of 12 months. A loan classified as doubtful has all the weaknesses inherent in assets that were classified as substandard, with the added characteristic that the weaknesses make realisation of the out standings in an advance account highly questionable and improbable.

Loss Assets: A loss asset is one where loss has been identified by the bank or internal or external auditors or the RBI inspectors but the amount has not been written off wholly. In other words, such an asset is considered uncollectible and of such little value that its continuance as a bankable asset is not warranted, although there may be some residual salvage or recovery value.

7.4.5.2 Provisioning Norms for NPA

Types of Assets	Rate of provision
Standard	Direct advances to agricultural and SME sectors at 0.25%, Residential housing loans beyond Rs 20 lakh at 1%, Advances to specific sectors, i.e., personal loans (including credit card receivables), loans and advances qualifying as Capital Market exposures, Commercial Real Estate loans, and Loans and Advances to Non-deposit taking Systemically Important NBFCs at 2 % and All other advances not included above, at 0.40%
Sub-standard	10% for all types of standard advance.
Doubtful assets	**i) Upto 1 year** 100% of unsecured advances and 20% of secured advances. **ii) One to 3 years** 100% of unsecured advances and 30 % of secured advances. iii)**More than 3 years** 100% of unsecured advances and 100% of secured advances.
Loss assets	100% of unsecured advances and 100% of secured advances.

Previous Year Question

Sub Unit – 7.4

June 2019

1. **Chalapathi Rao Committee was constituted for restructuring of:**
1. State Financial Corporation in India
2. Commercial Banks in India
3. Co-operative Banks in India
4. Regional Rural Banks in India

2. **Which among the following is NOT true about BASEL?**
1. Initially it was named as Committee of Banking Regulations and Supervisory Practices (CBRS)
2. BASEL was established by the Central Bank Governors of fifteen countries
3. It was established by the end of 1974
4. Disturbances in international currency and banking markets were responsible for its establishment

Answer with Reference

SL. NO.	ANSWER	REFERENCE NO.
1.	4	7.4.1
2.	2	7.4.3

Jan.-2017

1. **‘RWA’ with regard to capital adequacy stands for which one of the following?**
(1) Risk Withdrawal Adjustments
(2) Risk Withdrawal Arrangements
(3) Risk Weighted Assets
(4) Risk-free Weighted Assets

Answer with Reference

SL. NO.	ANSWER	REFERENCE NO.
1.	3	7.4.3

July 2016

1. **Match the items of List – I with List – II with regard to the BASEL III norms and select the correct code:**

List – I	**List – II**
a. Pillar 1	i. Supervisory review process
b. Pillar 2	ii. Market discipline
c. Pillar 3	iii. Minimum regulatory capital requirements based on Risk Weighted Assets (RWAs)

Codes :

	A	b	c
(1)	I	ii	iii
(2)	I	iii	ii
(3)	iii	ii	i
(4)	iii	I	ii

2. Identify the years in which different phases of Bank Nationalisation took place in India:

(a) 1950 (b) 1955 (e) 1969 (d) 1949 (e) 1980

a. (a), (b), (e), (d)

b. (b), (c), (e)

c. (b), (d), (e)

d. (c), (d), (e)

Answer with Reference

SL. NO.	ANSWER	REFERENCE NO.
1.	4	7.4.3
2.	B	7.4.1

June 2015

1. Match the items in List - I with the items in List - II :

List I	**List II**
a) ATM card	i) NPA
b) Debts due for more than 30 days	ii) John Shephard Barron
c) Micro finance	iii) State Finance Corporations Act
d) State level finance corporations	iv) NABARD

Codes:

	A	b	c	d
1)	I	iii	ii	iv
2)	ii	I	iv	iii
3)	iv	iii	ii	i
4)	ii	I	iii	iv

Answer with Reference

SL. NO.	ANSWER	REFERENCE NO.
1.	2	7.4.5.1

Sub Unit: 5 Financial markets: Money market; Capital market; Government securities market

7.5.1 Financial Market

It is a market where financial instruments or securities are traded between buyer and seller.

7.5.1.1 Classification of Financial Market

Financial market can be classified as money market and capital market. Again money market can be classified as organised money market and unorganised money market. On the other hand capital market can be classified as primary market and secondary market.

A) Money Market

It is a market where from the industries and enterprises collect its short term sources of finance. So it is a market where short term financial funds and short term financial assets are traded.

i) Organised money market

It is a money market which is governed by the specific rules and regulation of the competent authority i.e. Reserve Bank of India. So, different commercial banks, LIC, rural banks etc. are the main participants of the organised money market.

ii) Unorganised money market

It is portion of the money market which is not governed by the specific rules and regulations. The main participant of this portion is money lenders.

B) Capital Market

It is a market where from the industries and enterprises collect its long term sources of finance. So it is a market where long term financial funds and long term financial assets are traded.

i) Primary Market/New Issue market

Primary market deals with the new or first issue of the security.

ii) Secondary Market

Secondary market deals with the subsequent dealings of the securities except first issue. This market is also known as stock exchange.

Participant of primary market

The main participants of the primary market are issuer companies, the investing public and institutions, the government, underwriters, merchant bankers, etc.

Participant of secondary market

The main participants of the secondary marker are buyers and sellers of the securities, Government, Registrar & Transfer Agent (R&T) of the companies, Stock Exchange and its clearing house, Brokers and sub-brokers, Depository and depository Participants, etc.

7.5.1.2 Money market instruments

Treasury bill

It is a short term money market instrument having a maturity period of less than 364 days or 1 year and issued by the RBI on behalf of the Government to fulfil the short term requirement of the Government. Treasury Bills are issued at a discount rate and on the date of the maturity investors are given back the face value of the treasury bills. The difference between the issue price and the maturity price represent the amount of interest. Treasury bills are assumed to be the risk free security. At present, treasury bills are issued in three maturities — 91-day, 182-day and 364-day. In 1997 the government also issued 14-day immediate treasury bills.

Certificate of deposit

A certificate of deposit is an agreement to deposit money for a fixed period with a bank that will pay you interest. You can choose to invest for three months, six months, one year or five years. You will receive a higher interest rate for the longer time commitment. You promise to leave all the money, plus the interest, with the bank for the entire term.

Commercial papers

Commercial paper, also called CP, is a short term debt instrument issued by companies to raise funds generally for a time period up to one year. It is an unsecured money market instrument issued in the form of a promissory note and was introduced in India in the year 1990. Companies having high rating can issue commercial paper to fulfil their short term sources of funds.

Bill of exchange

According to the Negotiable Instruments Act 1881, 'a bill of exchange is defined as an instrument in writing containing an unconditional order, signed by the maker, directing a certain person to pay a certain sum of money only to, or to the order of a certain person or to the bearer of the instrument.'

Call money/Notice money/Term money

Call Money is the short term finance raised by commercial banks as inter-bank transactions with an aim to maintain the cash reserve ratio. It is a market where money is borrowed or lent on demand and has a maturity ranging between one day and two weeks. It is also known as Inter-bank call money market. The main purpose of Call/Notice market is to facilitate the commercial banks to bridge the gaps of shortfall of funds, to meet the sudden requirement of funds out of large outflows, and to fullfill the stipulated requirements of RBI such as the Cash Reserve Ratio (CRR) and the Statutory Liquidity Requirements (SLR). **Call money** is defined as the money borrowed or lent for a single day and repaid on the next working day. **Notice money** is defined as the money borrowed or lent for a period ranging between two to fourteen days. If the funds are transacted for more than 14 days then it is called as "**Term Money".**

7.5.1.3 Capital market instruments

Global Depository Receipts (GDRs)

A global depositary receipt (GDR) is a bank certificate issued in more than one country for shares in a foreign company. Global Depository Receipt (GDR) is an instrument in which a company located in domestic country issues one or more of its shares or convertibles bonds outside the domestic country. In GDR, an overseas depository bank i.e. bank outside the domestic territory of a company, issues shares of the company to residents outside the domestic territory. Such shares are in the form of depository receipt or certificate created by overseas the depository bank. Issue of Global Depository Receipt is one of the most popular ways to tap the global equity markets. A company can raise foreign currency funds by issuing equity shares in a foreign country. Each GDR represents a particular number of shares in a specific company.

American Depository Receipts (ADRs)

American depositary receipt (ADR) is a negotiable certificate issued by a U.S. depository bank representing a specified number of shares or as little as one share investment in a foreign company's stock. The ADR trades on markets in the U.S. as any stock would trade. ADRs enable domestic investors of U.S. to buy securities of foreign companies without the accompanying risks or inconveniences of cross-border and cross-currency transactions. Foreign firms also benefit from ADRs, as they make it easier to attract American investors and capital without the hassle and expense of listing themselves on U.S. stock exchanges. An ADRs represent a feasible, liquid way for U.S. investors to purchase stock in companies abroad. The certificates also provide access to foreign listed companies that would not be open to U.S. investment otherwise.

Convertibles

A convertible bond is a type of debt security that provide an investor with a right or an obligation to exchange the bond for a predetermined number of shares in the issuing company at certain times of a bond's life. It is considered as hybrid security which includes the features of both debt and equity.

Foreign Currency Convertible Bonds (FCCBs)

It is a bond issued by the company with an aim of collecting foreign currency and it is subscribed by the non-resident in foreign currency. This bond is convertible into ordinary shares of the issuing company in any manner, either in whole or in part on the basis of only equity related warrant attached to the debt instrument.

7.5.1.4 Distinguish between Primary market and secondary Market

Primary market	Secondary Market
It deals with first issue of securities.	It deals with subsequent trading of securities.
It is necessary for creation and augmentation of capital.	It is necessary to sustain the generated capital.
The issuer company involved in it.	The issuer company is normally not involved in it.
New creation of capital is possible	No new creation of capital is possible.

7.5.1.5 Distinguish between Capital market and money market

Capital market	Money market
This market deals with the long term sources of finance.	This market deals with the short term sources of finance.
This market is regulated by SEBI	This market is regulated by RBI
Stock exchange, brokers, depository, Depository participant are main participants.	Central banks, commercial banks are the main participants
This market involves more risk	This market involves low risk
Debenture, shares etc. are main instruments of capital market.	Treasury bills, commercial paper, certificate of deposit are main instruments of money market.

7.5.2 Stock Exchange in India

The Securities Contracts (Regulation) Act of 1956defines a stock exchange as "any body of individuals, whether incorporated or not, constituted before corporatization and demutualization" or "a body corporate incorporated under the Companies Act, 1956 whether under a scheme of corporatization and demutualization or otherwise," for the purpose of assisting, regulating or controlling the business of buying, selling or dealing in securities. The BSE is the oldest stock exchange in Asia and it was established in the year 1875 and was the first to be granted permanent recognition under the Securities Contract Regulation Act, 1956.

The BSE was followed by the Ahmedabad Stock Exchange in 1894 which focused on trading in shares of textile mills. The Calcutta Stock Exchange began operations in 1908 and began trading shares of plantations and jute mills. The Madras Stock Exchange followed, being set up in 1920. In the year 1988 SEBI was established as a non- statutory body and in the year 1992 it was made statutory and started working as an apex body of capital market in India. In the year 1991 Over The Counter Exchange of India (OTCEI) was established to introduced first computerised trading in India. After the Harshad Mehta scam in 1992, there was a pressing need for another stock exchange large enough to compete with the BSE and bring transparency to the stock market. This gave birth to the National Stock Exchange (NSE). It was incorporated in 1992, become recognized as a stock exchange in 1993, and trading began on it in 1994. It was the first stock exchange on which trading took place electronically. In response to this competition, BSE also introduced an electronic trading system known as BSE On-line Trading (BOLT) in 1995.

7.5.2.1 National Stock exchange (NSE)

The National Stock Exchange of India Limited (NSE or NSEIL) was set up by IDBI and some other all India financial institutions in November 1992 with a paid up capital of Rs. 25 crores . It was establish on the basis of recommendations of the study group under the chairmanship of M.J.Pherwani.

Objectives:

- To established a nation- wide trading facility for the various financial instruments.
- To ensure equal access to the investors all over the country.
- To enable shorter settlement cycle and book entry settlement system.
- To meet the current international standard in the securities market.

7.5.2.2 Over The Counter exchange of India (OTCEI)

Over The Counter Exchange of India (OTCEI) was set up with a paid up capital of Rs.5 , crores in Oct.1990jointly by the UTI, ICICI, IDBI, SBI Capital Market Limited, IFCI, LICI, GICI and its subsidiaries and Canbank Financial Services Ltd.

Objectives:

- To offer small and medium sized companies' access to a market nationwide as well as a chance to raise finance in a cost effective manner from capital market.
- To provide a convenient avenue of investment under the capital market segment for the investors and
- To implement a computerised, scrip-less stock exchange with trading and settlement standard in tune with the global standards.

*** Dematerialisation is a process through which physical securities such as share certificates and other documents are converted into electronic format and held in a Demat Account. Dematerialisation offers flexibility along with security and convenience. Holding share certificates in physical format carried risks like certificate forgeries, loss of important share certificates, and consequent delays in certificate transfers. Dematerialization eliminates these hassles by allowing customers to convert their physical certificates into electronic format. A depository is responsible for holding the securities of a shareholder in electronic form. These securities could be in the form of bonds, government securities, and mutual fund units, which

are held by a registered Depository Participant (DP). A DP is an agent of the depository providing depository services to traders and investors.
Currently, there are two depositories registered with SEBI and are licensed to operate in India:
NSDL (National Securities Depository Ltd.)
CDSL[Central Depository Services (India) Ltd.]

Re-materialisation

Re-materialisation is the process by which a client can get his electronic holdings converted into physical certificates. The client has to submit the re-materialisation request to the DP with whom he has an account. The DP enters the request in its system which blocks the client's holdings to that extent automatically. The DP releases the request to NSDL and sends the request form to the Issuer/ R&T agent. The Issuer/ R&T agent then prints the certificates, despatches the same to the client and simultaneously electronically confirms the acceptance of the request to NSDL. Thereafter, the client's blocked balances are debited.

7.5.3 Securities Exchange Board of India (SEBI)

Securities and Exchange Board of India (SEBI) is a statutory regulatory body entrusted with the responsibility to regulate the Indian capital markets. It monitors and regulates the securities market and protects the interests of the investors by enforcing certain rules and regulations.
SEBI was founded on April 12, 1992, under the SEBI Act, 1992. Headquartered in Mumbai, India, SEBI has regional offices in New Delhi, Chennai, Kolkata and Ahmedabad along with other local regional offices across prominent cities in India.
The objective of SEBI is to ensure that the Indian capital market works in a systematic manner and provide investors with a transparent environment for their investment. To put it simply, the primary reason for setting up SEBI was **to prevent malpractices in the capital market of India, to provide protection to the investors, to promote fair and proper function of capital market and promote the development of the capital markets.**

Functions of SEBI

- Protecting general investors from various dishonest practices of the company officials,
- Registering and regulating the working of stock brokers and sub-brokers,
- Registering and regulating the working of mutual funds,
- Registering and regulating the working of share transfer agent, bankers to an issue, merchant bankers, etc.
- Regulating the overall business of the stock exchanges,
- Prohibiting insider trading in securities,
- Promoting investors’ education,
- Arranging of training of intermediaries
- Publishing information useful for all market participants
- Levying various fees and other charges for carrying out its work.

7.5.4 Government Securities Market

A government security (G-Sec) is a tradable instrument issued by the central government or state governments. It acknowledges the government’s debt obligations. Such securities are short term called treasury bills with original maturities of less than one year, or long term called government bonds or dated securities with original maturity of one year or more. In India, the central government issues both: treasury bills and bonds or dated securities, while state governments issue only bonds or dated securities, which are called the state development loans. Since they are issued by the government, they carry no risk of default, and hence, are called **risk-free gilt-edged instruments.**

7.5.4.1 Players in the Govt. Securities Market

Major players in the G-Secs. market include commercial banks and primary dealers (PDs) besides institutional investors like insurance companies. Other participants include co-operative banks, regional rural banks, mutual funds, provident and pension funds. FPIs are allowed to participate in the G-Secs. market within the quantitative limits prescribed from time to time. Corporates also buy or sell G-Secs. to manage their overall portfolio.

7.5.4.2 Reasons of volatility in Govt. Securities Market

G- Sec prices fluctuate sharply in the secondary markets. The price is determined by demand and supply of the securities. The price is influenced by the level and changes in interest rates in the economy and other macro-economic factors, such as, liquidity and inflation. Developments in other markets like money, foreign exchange, credit and capital markets also affect the price of the G-Secs. Further, developments in international bond markets, specifically the US Treasuries affect prices of G-Secs.

7.5.4.3 Features of Govt. securities Market

- Issued at face value
- No default risk involved as payment of interest and principal is garneted by Government.
- Sufficient liquidity as an investor can sale it in the secondary market at any time
- Interest is paid on half-yearly basis on face value
- No tax is deducted at source
- Can be held in D-mat form
- Redeemed at face value on maturity
- Rate of interest and period of maturity is fixed at the time of issue and not changeable during the tenor.

7.5.4.4 How to buy Govt. Securities?

You can buy government securities in many different ways. A simple and popular way to purchase Treasury securities is through Treasury Direct. Treasury Direct is an online platform that the Treasury Department sponsors. You can also buy government securities though the U.S. Treasury. A final option is to buy them on secondary markets through a financial institution, broker or dealer.

7.5.4.5 Govt. Security Market Instruments

Treasury Bills (T-bills)

Treasury bills or T-bills, which are money market instruments, are short term debt instruments issued by the Government of India and are presently issued in three tenors, namely, 91 day, 182 day and 364 day. Treasury bills are zero coupon securities and pay no interest. They are issued at a discount and redeemed at the face value at maturity.

Cash Management Bills (CMBs)

In 2010, Government of India, in consultation with RBI introduced a new short-term instrument, known as Cash Management Bills (CMBs), to meet the temporary mismatches in the cash flow of the Government of India. The CMBs have the generic character of T-bills but are issued for maturities less than 91 days.

Dated G-Secs

Dated G-Secs are securities which carry a fixed or floating interest rate which is paid on the face value, on half-yearly basis. Generally, the tenor of dated securities is between 5 years and 30 years. In the recent auction calendar for dated G-Secs, there is a plan to issue 40 year dated security in 2015-16.

Previous Year Question

Sub Unit – 7.5

July- 2016

1. **Match the items of Column – I with the items in Column – II and suggest the correct code :**

Column – I	Column – II
a. Interbank call market	i. Money market
b. Commercial Bills	ii. Promissory note
c. Commercial paper market	iii. Short-term maturity
d. Treasury bills	iv. Government papers

Codes :

	a	b	c	d
(1)	i	ii	iv	iii
(2)	iii	I	ii	iv
(3)	i	iii	iv	ii
(4)	iv	iii	ii	i

2. **Re-materialisation of securities is meant by**
(1) Repossession of securities
(2) Re-holding in Physical form
(3) Repurchase of securities
(4) Restoring the lost right

Answer with Reference

SL. NO.	ANSWER	REFERENCE NO.
1.	2	7.5.1.2
2.	2	7.5.2.2

Dec.-2015

1.For the discharge of its functions efficiently, SEBI has been vested with the following powers :

(a) to approve bylaws of stock exchanges
(b) to direct the stock exchanges to amend their bylaws
(c) inspect the books of accounts and call for periodical returns from recognized stock exchanges
(d) inspect the books of accounts of financial intermediaries
(e) compel certain companies to list their shares in one or more stock exchanges
(f) registration of brokers

a. (a), (b), (c) and (f)
b. (a), (c), (d) and (f)
c. (b), (c), (d), (e) and (f)
d. (a), (b), (c), (d), (e) and (f)

Answer with Reference

SL. NO.	ANSWER	REFERENCE NO.
1.	D	7.5.2.2

June 2015

1. **Assertion (A) :** A well-developed money market is the basis for an effective monetary policy. It is in the money market that the Central Bank comes into contact with the financial sectors of the economy as a whole and it is through the liquidity in the market that influence the cost and availability of credit.

Reasoning (R): A well-organized money market is an essential condition for the successful operation of the Central Banking policies, and for holding the conditions of liquidity within the bounds of what the monetary authorities consider desirable.

a. (A) is true but (R) is false
b. (R) is true but (A) is false
c. (A) is true and (R) offers correct explanation to (A)
d. Both (A) and (R) are false

2.Match the items of List - I with the items of List - II and select a correct code :

List I	**List II**
a) SEBI	(i) Exchange for small companies
b)RBI	(ii) Secondary market in treasury bills
c) STCI	(iii) Regulation of secondary market
d)OTCEI	(iv) Ad-hoc treasury bills

Codes:

	A	**b**	**c**	**d**
1.	(iv)	(ii)	(iii)	(i)
2.	(iii)	(iv)	(ii)	(i)
3.	(iii)	(i)	(ii)	(iv)
4.	(ii)	(iii)	(i)	(iv)

Answer with Reference

SL. NO.	ANSWER	REFERENCE NO.
1.	C	7.5.1.1
2.	B	7.5.2.2

Sub Unit-6 Financial Institutions: Development Finance Institutions (DFIs); Non-Banking Financial Companies (NBFCs); Mutual Funds; Pension Funds

Sl. No.	Topics
42	7.6.1 Development Financial Institutions (DFIs)
43	7.6.1.1 Objectives of Development Banks
44	7.6.1.2 Industrial Development Bank of India (IDBI)
45	7.6.1.3 Industrial Finance Corporation of India (IFCI)
46	7.6.1.4 Industrial Credit and Investment Corporation of India(ICICI)
47	7.6.1.5 Small Industries Development Bank of India (SIDBI)
48	7.6.1.6 National Bank for Agriculture and Rural Development (NABARD)
49	7.6.1.7 State Financial Corporation (SFCs)
50	7.6.2 Non-Banking Financial Companies (NBFCs)
51	7.6.2.1 Features of NBFCs
52	7.6.2.2 Types of NBFC
53	7.6.2.3 Role of NBFCs
54	7.6.3 Mutual Funds
55	7.6.3.1 Objectives of mutual funds
56	7.6.3.2 What is Net Assets Value (NAV)?
57	7.6.3.3 What is Assets Management Company (AMC)?
58	7.6.3.4 Structure of Mutual Funds
59	7.6.3.5 Types of Mutual Funds
60	7.6.3.6 Limitations of Mutual funds
61	7.6.4 Pension Funds
62	7.6.4.1 Types of Pension Funds in India

7.6.1 Development Financial Institutions (DFIs)

A development financial institution is intended to provide a necessary capital, enterprise, managerial and technical know-how as these are inadequate in developing economy like India. They also assist in building up the financial and socio-economic infrastructure, favourable to quick economic development. The development finance institutions or development finance companies are organizations owned by the government or charitable institution to provide funds for low-capital projects or where their borrowers are unable to get it from commercial lenders.

7.6.1.1 Objectives of Development Banks

- The prime objective of DFI is the economic development of the country
- These banks provide financial as well as the technical support to various sectors
- DFIs do not accept deposits from people
- They raise funds by borrowing funds from governments and by selling their bonds to the general public
- It also provides a guarantee to banks on behalf of companies and subscription to shares, debentures etc.
- Underwriting enables firms to raise funds from the public. In Underwriting a financial institution guarantees to purchase a certain percentage of shares of a company which is issuing IPO if it not subscribed by Public.
- They also provide technical assistance like Project Report, Viability study and consultancy services.

7.6.1.2 Industrial Development Bank of India (IDBI)

IDBI Bank is an Indian government-owned financial service company, formerly known as **Industrial Development Bank of India**, headquartered in Mumbai, India. It was established in 1964 by an Act of Parliament to provide credit and other financial facilities for the development of the fledgling Indian industry.

Functions of IDBI

- Providing financial support for the industries: The long term financial assistance say for 25 years.
- Undertake market study and research for finding the investment opportunity relate to industrial development.
- Promoting institutions working for industrial development.
- Providing technical and administrative assistance for the promotion and expansion of industries.
- Coordinating and supervising the activities of the institutions working in the financing sector.
- Facilitate balanced industrial development across India.
- To render financial assistance to industrial concerns. IDBI operates various schemes of assistance. e.g., Direct Assistance Scheme, Soft Loans Scheme, Technical Development Fund Scheme, Refinance Industrial Loans Scheme, Bill Re-discounting Scheme, Seed Capital Assistance Scheme, Overseas Investment Finance Scheme, Development Assistance Fund, etc.

****_Soft Loan Scheme**

IDBI introduced in 1976 the soft loan scheme to provide financial assistance to product units in selected industries viz., cement, cotton, textiles. jute, sugar and certain engineering industries to modernize. Financial replace and renovate their plant and equipment so as to achieve higher and more economic levels of production. This scheme is implemented by IDBI with .financial participation by IFCI and ICICI. The basic criteria for assistance under the scheme are the weakness or non-viability of industrial concerns arising out of mechanical obsolescence. Industrial concerns which are not in a position 10 bear the normal lending rate of interest of the financial institutions are provided on accessional assistance to the full extent of the loan. In other cases the limit of concessional assistance is 66 per cent of the loan.

Technical Development Fund Scheme

The Government of India introduced the Technical Development Fund (TDF) Scheme in March. 1976 for issue of import licenses for import of small value balancing equipment, technical know-how, foreign consultancy services and drawings and designs by industrial units to enable them to achieve fuller capacity utilization, technological up gradation and higher exports. Some industrial units found it difficult to take advantage of the import license issued under this scheme for want of rupee resources. In January, 1977, IDBI introduced a scheme for providing matching rupee loans to industrial units to enable them to utilize import licenses issued under TDF scheme. The scheme which was started for six specified industries now covers all industries as also import of any other input needed by the industrial units for improving export capabilities. This scheme of the bank has not been successful as only one-fourth of the units sought this assistance.

Seed Capital Assistance:-

With a view to help first generation entrepreneurs who have the skills but lack financial resources, IDBI started seed capital assistance scheme in September, 1976. Under the first scheme, Financial Corporations provide seed capital assistance to projects in small scale sector from their special class of share capital contributed by IDBI and the state government. The maximum amount of assistance under this scheme is to meet the gap in the equity contribution which is 20 per cent of the cost of the project.

7.6.1.3 Industrial Finance Corporation of India (IFCI)

Initially established in 1948, the Industrial Finance Corporation of India was converted into a public company on 1 July 1993 and is now known as Industrial Finance Corporation of India Ltd. The main aim of setting up this development bank was to provide assistance to the industrial sector and manufacturing sector to meet their medium and long-term financial needs.

Functions

- Granting loans and advances to industrial concerns and subscribing to the shares and debentures floated by them;
- Underwriting the issue of stocks, shares, debentures and bonds of industrial concerns provided these stocks, shares etc., are disposed of by the Corporation within seven years;
- Guaranteeing loans raised by industrial concerns in the capital market;
- Granting loans in foreign currencies to specified industries

International Finance Corporation (IFC)

The IBRD loans are available only to member country governments or with the guarantee of member-country governments. Further IBRD can only make a loan but it cannot participate in the quality of the project financed. IFC was established in 1956 with the specific purpose of financing private enterprises. It is an affiliate of IBRD. The Board of Governors of the IBRD also constitute the Board of Governors of the IFC. But it is a separate entity with funds kept separate from those of IBRD.

Functions of International Finance Corporation

The purpose of IFC is to further the economic development by encouraging growth of private enterprise in member countries particularly in less-developed areas, thus supplementing the activities of the IBRD The IFC, therefore,

(i) invests in private enterprises in member countries in association with private investors and without government guarantee, in case where sufficient private capital is not available on reasonable terms;

(ii) seeks to bring together investment opportunities, private capital of both foreign and domestic origin, and experienced management, and

(iii) stimulates conditions conducive to the flow of private capital, domestic and foreign, into productive investments in member-countries.

7.6.1.4 Industrial Credit and Investment Corporation of India(ICICI)

Industrial Credit and Investment Corporation of India (ICICI) was incorporated in the year 1955, as a company registered under the Companies Act. The ICICI was incorporated to finance small scale and medium industries in the private sector.

Functions

- Providing finance in the form of long-term or medium term loans or equity participation.
- Sponsoring and underwriting new issues of shares and other securities,
- Guaranteeing loans from other private investment sources.
- Making funds available for reinvestment by revolving investment as rapidly as possible.
- Providing project advisory services i.e. offering advice – to private sector companies in the pre-investment stages on Government policies and procedures, feasibility studies and joint venture search, and to Central and State Governments on specific policy related issues.

7.6.1.5 Small Industries Development Bank of India (SIDBI)

In order to promote small scale industries in the country, a special Act was passed in Parliament in April 1990 for starting of Small Industries Development Bank of India. SIDBI is a wholly owned subsidiary of IDBI. It is providing assistance to all those institutions which are promoting small scale industries. SIDBI was set up as a subsidiary of IDBI to take over the functions of small business financing of IDBI

Functions

- SIDBI refinances loans that are extended by financial institutions to small scale industries
- Helps in expanding marketing channels for the products of Small Scale Industries
- It offers services like factoring, leasing etc. to small-scale sector
- Promotes employment opportunities across small scale industries in semi-urban areas
- Initiates steps towards technology up gradations
- Enables credit flow as working capital or as term loans to Small Scale Industries

Unit Trust of India (UTI)

Unit Trust of India (UTI) is a statutory public sector investment institution which was set up in February 1964 under the Unit Trust of India Act, 1963. UTI began operations in July 1964. It provides opportunity for small-savers to invest in areas where their risk is diversified.

Objectives:

(i) To encourage and pool the savings of the middle and low income groups.

(ii) To enable them to share the benefits and prosperity of the industrial development in the country.

Functions of UTI:

(i) To accept discount, purchase or sell bills of exchange, promissory note, bill of lading, warehouse receipt, documents of title to goods etc.,

(ii) To grant loans and advances.

(iii) To provide merchant banking and investment advisory service.

(iv) To provide leasing and hire purchase business.

(v) To extend portfolio management service to persons residing outside India.

(vi) To buy or sell or deal in foreign exchange dealings.

(vii) To formulate unit scheme or insurance plan in association with or as agent of GIC.

(viii) To invest in any security floated by the Central Government, RBI or foreign bank.

7.6.1.6 National Bank for Agriculture and Rural Development (NABARD)

It is the apex banking institution to provide finance for Agriculture and rural development. National Bank for Agriculture and Rural Development (NABARD) was established on July 12, 1982 with the paid up capital of Rs. 100 cr. by 50: 50 contribution of government of India and Reserve bank of India. It is an apex institution in rural credit structure for providing credit for promotion of agriculture, small scale industries, cottage and village industries, handicrafts etc.

Functions

- It acts as an apex body for meeting the credit needs of all types of agricultural and rural development.
- It provides refinancing facilities to State Co-operative Banks (SCBs), Land Development Bank (LDBs), Regional Rural Banks (RRBs) and other approved financial institutions for financing rural economic activities.
- It co-ordinates all agricultural and rural development activities with the objective of tying them up with planned development activities in the rural sector.
- It provides short-term, medium-term and long-term credit to SCBs, LDBs, RRBs and approved financial institutions.
- It provides long-term assistance (not exceeding 20 years) to State Governments.

- It has the responsibility of inspecting co-operative banks and RRBs.
- It maintains a research and development fund to promote research in agriculture and rural development.

7.6.1.7 State Financial Corporation (SFCs)

Government of India passed State Financial Corporation Act in the year 1951 and empower the state to established State Financial Corporation. The main objective of establishing State Financial Corporation was to meet the financial needs of small and medium scale industrial units which are not governed by the Industrial Financial Corporation. The first State Financial Corporation was established in Punjab in the year 1953. Presently 18 SFCs are operating in India.

Functions

- The SFCs provides loans mainly for the acquisition of fixed assets like land, building, plant, and machinery.
- The SFCs help financial assistance to industrial units whose paid-up capital and reserves do not exceed Rs. 3 crore (or such higher limit up to Rs. 30 crores as may be notified by the central government).
- The SFCs underwrite new stocks, shares, debentures etc., of industrial units.
- The SFCs grant guarantee loans raised in the capital market by scheduled banks, industrial concerns, and state co-operative banks to be repayable within 20 years.

7.6.2 Non-Banking Financial Companies (NBFCs)

As per RBI "A Non-Banking Financial Company (NBFC) is a company registered under the Companies Act, 1956 engaged in the business of loans and advances, acquisition of shares/stocks/bonds/debentures/securities issued by Government or local authority or other marketable securities of a like nature, leasing, hire-purchase, insurance business, chit business but does not include any institution whose principal business is that of agriculture activity, industrial activity, purchase or sale of any goods (other than securities) or providing any services and sale/purchase/construction of immovable property. A non-banking institution which is a company and has principal business of receiving deposits under any scheme or arrangement in one lump sum or in instalments by way of contributions or in any other manner, is also a non-banking financial company (Residuary non-banking company)."

A NBFC cannot accept public deposits by allowing people to open savings or current accounts with it. A NBFC also cannot issue cheques and drafts. Deposit insurance facility of Deposit Insurance and Credit Guarantee Corporation is not available to depositors of NBFCs, unlike in case of banks.

7.6.2.1 Features of NBFCs

- Its main function is giving loans and advances, assets financing, investing in shares, debentures and different marketable securities.
- It provides capital loans and credit facilities.
- NBFCs provide and make investments and hence their activities are similar to that of banks.
- NBFC companies are involved in providing a wide range of financial services which includes insurance, stock-broking, loans for homes, machinery, mobile phones etc.

- NBFC does not include financial institutions which are engaged in agriculture activity, industrial movement, purchase or sale of any goods or providing any services and construction of resolute property.
- Provide loan and credit facilities and support investment in properties.

7.6.2.2 Types of NBFC

Asset Finance Company (AFC) : An AFC is a company which is a financial institution carrying on as its principal business the financing of physical assets supporting productive/economic activity, such as automobiles, tractors, lathe machines, generator sets, earth moving and material handling equipments, moving on own power and general purpose industrial machines.
Investment Company (IC) : IC means any company which is a financial institution carrying on as its principal business the acquisition of securities,
Loan Company (LC): LC means any company which is a financial institution carrying on as its principal business the providing of finance whether by making loans or advances or otherwise for any activity other than its own but does not include an Asset Finance Company.
Infrastructure Finance Company (IFC): IFC is a non-banking finance company a) which deploys at least 75 per cent of its total assets in infrastructure loans, b) has a minimum Net Owned Funds of Rs 300 crore, c) has a minimum credit rating of ‘A ‘or equivalent d) and a CRAR of 15%.
Systemically Important Core Investment Company (CIC-ND-SI): CIC-ND-SI is an NBFC carrying on the business of acquisition of shares and securities.
Infrastructure Debt Fund: Non- Banking Financial Company (IDF-NBFC) : IDF-NBFC is a company registered as NBFC to facilitate the flow of long term debt into infrastructure projects.
Non-Banking Financial Company – Factors (NBFC-Factors): NBFC-Factor is a non-deposit taking NBFC engaged in the principal business of factoring.

7.6.2.3 Role of NBFCs

As per RBI following roles are performed by the NBFC

- Development of transport and infrastructure sectors.
- Generation of employment
- Help in capital formation
- Development of economy
- To finance economically weaker section of the society
- Huge contribution to exchequer
- Development in financial market
- Help in mobilization of savings.

7.6.3 Mutual Funds

A mutual fund is an investment vehicle where many investors pool their money to earn returns on their capital over a period. This corpus of funds is managed by an investment professional known as a fund manager or portfolio manager. It is his/her job to invest the corpus in different securities such as bonds, stocks, gold and other assets and seek to provide potential returns.

The gains (or losses) on the investment are shared collectively by the investors in proportion to their contribution to the fund.

7.6.3.1 Objectives of mutual funds

i. To provide an opportunity for lower income groups or small investors a decent investment scheme,

ii. To provide a good amount of return to the investors from an indirect investment in equity,

iii. To provide a moderately risky investment mode to the general investors who may not like to take the high risk of going directly to share market for investment.

7.6.3.2 What is Net Assets Value (NAV)?

It is the actual value of the investments made by the mutual fund for each unit issued by it. Net Asset Value (NAV) is the market value of a mutual fund unit. The overall cost of a mutual fund depends on this market value per fund unit.

Net Assets Value
(NAV)=

$$\frac{Value\ of\ investment + Receivables + Accrued\ Income + Other\ Current\ Assets - Liabilities - Accrued\ Expenses}{No.of\ Outstanding\ Unit}$$

Performance of Mutual Fund is evaluated by using Sharpe Model, Jenson model and Treynor model.

7.6.3.3 What is Assets Management Company (AMC)?

Asset management refers to the management of people’s assets. The term also applies to dealing with other organizations’ or companies’ investments. Assets include either intangible or intangible assets. **Asset Management Company** is a company that takes the financial assets of a person, company or another asset management company (generally this will be high net worth individuals) and use the assets to invest in companies that use those as an operational investment, financial investment or any other investment in order to grow the investment; post which, the returns will be returned to the actual investor and a small amount of the returns are held back as a profit with the asset management company.

7.6.3.4 Structure of Mutual Funds

In India, the following entities are involved in a mutual fund operation: The Sponsor of the mutual fund, the Trustees, the Assets Management Company (AMC), the Custodian and the Registrar and Transfer Agent (R& T).

7.6.3.5 Types of Mutual Funds

Following types of mutual funds are available in the market-

Based on assets class

Equity/Stock Fund

In case of stock fund entire subscription are invested by the institution into equity shares and stocks. In this mutual fund investor has to face more risk and get a chance of higher return.

Debt Fund

In case of stock fund entire subscriptions are invested by the institution into debenture and bond. In this mutual fund investor has to face low risk and get a chance of lower return

Balanced Fund

In balance fund entire subscriptions are invested by the institution between equity shares and bond by making a proper blend.

Money Market Fund

In case of stock fund entire subscriptions are invested by the institution into money market instruments.

Based on structure

Open ended fund are those which are open for sale by the institution throughout the year so that willing persons can make an investment.

Close ended fund are those which are open for sale by the institution only during a specified period.

Interval Funds bridge the gap between open-ended and close-ended mutual funds. Much like close-ended mutual funds, they are available as an initial offering and are then opened for the repurchase of shares by the fund management company at different intervals during the tenure of the fund. Initial unit holders can offload their shares by selling it to the mutual fund house.

Based on Investment Goals

Growth Fund

Growth mutual funds invest the money primarily in growth-sector equity stocks. As their name suggests, the main objective of Growth Mutual funds is capital appreciation. They are not considered suitable for long-term investments and also occupy a high-risk grade.

Income Fund

Fixed-income mutual funds are a sub-class of debt mutual funds. These funds distribute the money in a mix of income assets such as debentures, bonds, securities, and certificates of deposits.

Tax Savings Fund

Tax Saving Mutual Funds, or Equity-linked Saving Scheme (ELSS), are funds that invest the money in equity. The money invested in these schemes is eligible for deductions under Section 80C of the Income Tax Act. While they are high on risk, they can offer a handsome return if the fund performs well.

Example: Motilal -Oswal Long Term Equity Fund

Capital Protection Fund

If protecting the principal is the priority, capital protection fund serves the purpose while earning relatively smaller returns (12% at best). The fund manager invests a portion of the money in bonds or Certificates of Deposits and the rest towards equities.

Pension Fund

Pension mutual funds are really long-term investments that are availed to gain regular returns after the investor retires. Pension funds split the investment between equity and debt instruments so that the equity component offers higher returns while the debt component balances the risk while providing low but steady returns.

Example: Franklin India pension plan.

Based on Specialisation

Sector Funds

Sector funds invest solely in one specific sector, theme-based mutual funds. As these funds invest only in specific sectors with only a few stocks, the risk factor is on the higher side.

Index Funds

Index Mutual Funds, also known as Exchange Traded Funds (ETFs), is a class of mutual fund schemes that not only track but also replicate the asset allocation of a certain index. Normally, index mutual funds are required to have an investment portfolio that is at least 95% similar to the index that it is tracking.

Example: SBI Nifty Index Fund (Growth)

Real Estate Funds

Real estate funds are those where the subscription is invested in real estate ventures.

7.6.3.6 Limitations of Mutual funds

Following are the limitations of the mutual funds-

1. **No Insurance:**

Mutual fund, although regulated by the SEBI, are not insured against losses. It is possible that investors could even loss their entire investment in some extreme cases.

2. **Fee and Expenses:**

Investor has to pay investment management fee and fund distribution costs as a percentage of the value of his investments as long as he hold the units, irrespective of the performance of the fund.

3. **Poor Performance:**

Returns on mutual funds are no means guaranteed.

4. Inadequate research done by the mutual fund organisation before investment.

5. In mutual fund certain information which is crucial for the investors may not be disclosed by the mutual fund organisation.

7.6.4 Pension Funds

A pension fund, also known as a superannuation fund in some countries, is any plan, fund, or scheme that provides retirement income. Pension funds are pooled monetary contributions from pension plans set up by employers, unions, or other organizations to provide for their employees' or members' retirement benefits.

7.6.4.1 Types of Pension Funds in India

Pension fund can broadly be classified as Employees Provident Fund (EPF) scheme which was introduced to promote retirement savings. EPF is governed by the Employees’ Provident Fund & Misc. Provisions Act, 1952. There are three schemes under this act namely-

Employee’s Provident Fund (EPF): Its main objective is to promote retirement savings.

Employees’ Pension Scheme (EPS) : Its main objective is to provide post retirement pension.

Employees Deposit Linked Insurance scheme (EDLI): Its main objective is to provide relief to family members in case of a subscriber’s untimely death.

Voluntary Provident Fund: It is a voluntary contribution that you make towards your Employee Provident Fund (EPF). A

Public Provident Fund (PPF)

It is a long term saving instrument to provide income security in retirement years. PPF was introduced for the benefit of self-employees and workers in the unorganised sector. Any resident Indian and minors can open a PPF account.

Previous Year Question

Sub Unit – 7.6

June-2019

1. **SIDBI was set up as a subsidiary of IDBI to:**
1. Takeover the functions of small business financing of IDBI
2. Takeover the venture capital operation of IDBI
3. Reconstruct and rehabilitate the sick and closed industrial units financed by IDBI
4. Facilitate, finance and promote India's foreign trade

2. **Which among the following is NOT included in negotiable instrument?**
1. Cheque
2. Demand Draft
3. Promissory Note
4. Mutual Fund

Answer with Reference

SL. NO.	ANSWER	REFERENCE NO.
1.	1	7.6.1.5
2.	4	7.6.3

July- 2018

1. Which one of the following is not the function of NABARD?

(1) To provide refinance assistance by way of short term credit to state cooperative banks and sectoral rural banks, etc., approved by the RBI for some specific purposes.
(2) To undertake inspection of cooperative societies other than primary cooperative societies and RRBs.
(3) To promote research in various aspects of the problems of urban development.
(4) To subscribe to share capital or invest in securities of any institution concerned with agricultural and rural development.

2. **Which one of the following financial institutions co-ordinates the functions and operations of all the financial institutions into a single integrated financial structure so that each may contribute to the growth of the economy ?**

(1) IFCI
(2) UTI
(3) IDBI
4) SIDBI

3. **Which one of the following is not the objective of UTI?**

(1) To mobilise savings of the community by offering savers the triple benefits of safety, liquidity and profitability of Investments.
(2) To channelize the pooled savings into productive outlets.
(3) To provide finance under hire purchase finance and housing finance to its members.
(4) To give everyone a chance to indirectly own shares and securities in a large number of select companies.

4. **Which one of the following is the main objective of IFCI?**

(1) To offer both small and large investors the means of acquiring shares in the widening prosperity resulting from the steady industrial growth of the country.
(2) To upgrade technology, modernization and to promote marketing of products of small scale sector.
(3) To serve as the apex institution for term finance for industry with coordination, regulation and supervision of the working of other financial institution.
(4) To provide medium and long term financial assistance to industrial undertakings, particularly in those circumstances in which banking accommodation is in appropriate or resource to capital market is impracticable.

Answer with Reference

SL. NO.	ANSWER	REFERENCE NO.
1.	1	7.6.1.6
2.	3	7.6.1.2
3.	3	7.6.1.5
4.	4	7.6.1.3

Jan.- 2017

1. SIDBI was set up as a subsidiary of IDBI to
(1) Take over the functions of small business financing of IDBI.
(2) Take over the venture capital operations of ICICI.
(3) Reconstruct and rehabilitate the sick and closed industrial units financed by IDBI.
(4) Facilitate, finance and promote India’s Foreign trade.

Answer with Reference

SL. NO.	ANSWER	REFERENCE NO.
1.	1	7.6.1.5

Nov. -2017

1.Match the following items of List - I with the items of List - II and indicate the code of correct matching :

List - I (Name of organisation)	**List - II (Year of establishment)**
1. (a) IDBI	(i) 1956
2. (b) ICICI	(ii) 1955
3. (c) LIC of India	(iii) 1990
4. (d) SIDBI	(iv) 1964

5. **Code :**

	(a)	(b)	(c)	(d)
(1)	(iii)	(i)	(ii)	(iv)
(2)	(iii)	(i)	(iv)	(ii)
(3)	(iv)	(ii)	(i)	(iii)
(4)	(i)	(ii)	(iii)	(iv)

2. **Match the following items of List-I with the items of List-II and indicate the code of correct matching.**

List – I (Name of Bank)	**List – II (Year of establishment)**
a. IFCI	i. 1981
b. SIDBI	ii. 1982
c. NABARD	iii. 1948
d. EXIM Bank	iv. 1990

Codes :

	a	b	c	d
(1)	iii	I	ii	iv
(2)	iv	ii	iii	i
(3)	iv	iii	ii	i
(4)	iii	iv	ii	i

3.**With a view to encourage newer classes of entrepreneurs and bringing about wider dispersal of ownership and control of industrial undertakings, IDBI operates a special scheme for supplementing the equity contribution to projects made by small and new entrepreneurs. This scheme is known as**

(1) Bridge Loan Scheme
(2) Soft Loan Scheme for Modernisation
(3) Technical Development Fund Scheme
(4) Seed Capital Assistance Scheme

4. Which one of the following is not the objective of UTI?
(1) To give everyone a chance to indirectly own shares and securities in a large number of select companies.
(2) To maximise mobilisation of people's savings by making insurance linked savings adequately attractive.
(3) To channelize the pooled savings into productive outlets.
(4) To mobilise savings of the community by offering savers the triple benefits of safety, liquidity and profitability of investments.

5. Match the items of List-I with List-II and denote the code of correct matching.

List – I	**List – II**
a. International Bank for Reconstruction and Development	i. 1945
b. International Finance Corporation	ii. 1956
c. Asian Development Bank	iii. 1966
d. Export-Import Bank of India	iv. 1981

Codes :

	A	b	c	d
(1)	i	ii	iii	iv
(2)	iv	iii	ii	i
(3)	I	iii	ii	iv
(4)	ii	i	iv	iii

6. Assertion (A) : International Finance Corporation (IFC) contributes to increase sustainable agriculture opportunities, improve health and education and increase access to financing for micro finance and business client.
Reasoning (R) : The IFC has focused on a set of development goals to ensure that its projects are expected to achieve the target.
Codes :
(1) Both (A) and (R) are correct, but (R) is not the correct explanation of (A).
(2) Both (A) and (R) are correct and (R) is the correct explanation of (A).
(3) (A) is correct but (R) is incorrect.
(4) Both (A) and (R) are incorrect.

Answer with Reference

SL. NO.	ANSWER	REFERENCE NO.
1.	3	7.6.1.2
2.	4	7.6.1.6
3.	4	7.6.1.2
4.	2	7.6.1.5
5.	1	7.6.1.3
6.	2	7.6.1.3

Sept. 2016

1. **Match the items of List – I with List – II with regard to the functions of NABARD :**

List – I	**List – II**
a. Financial Functions	i. Core Banking solution to co-operative banks
b. Developmental functions	ii. Credit monitoring arrangements
c. Supervisory functions	iii. Farm sector refinance through RRBs

Codes :

	A	b	c
(1)	iii	ii	i
(2)	iii	i	ii
(3)	ii	I	iii
(4)	i	iii	ii

Answer with Reference

SL. NO.	ANSWER	REFERENCE NO.
1.	2	7.6.1.6

July 2016

1. **Which of the following are not models used for evaluating the performance of Mutual Funds ?**
I. Sharpe Model
II. Miller Model
III. Lintner Model
IV. Jenson Model
V. Treynor Model
Codes :
(1) I, II, III
(2) I, IV, V
(3) I, II
(4) II, III

2. **Which one of the following development financial institutions in India has started the special refinance scheme for the resettlement and rehabilitation of voluntary retired workers of the National Textile Corporation of India ?**
(1) IDBI
(2) SIDBI
(3) ICICI
(4) None of the above

3. **Read the following statements and choose the correct code :**
Statement – I : Small Industry Development Bank of India (SIDBI) was set up as a wholly owned subsidiary of RBI.
Statement – II : SIDBI has taken over the responsibility of administering small industry development fund managed by IDBI.
Codes :
(1) only (I) is correct.
(2) Only (II) is correct.
(3) Both (I) and (II) are correct.
(4) Both (I) and (II) are wrong.

Answer with Reference

SL. NO.	ANSWER	REFERENCE NO.
1.	4	7.6.3.2
2.	1	7.6.1.2
3.	2	7.6.1.5

Dec.-2015

1. **Which of the following is not a development banking institution?**

A.IDBI

B.IFCI

C.EXIM BANK

D.ICICI

Answer with Reference

SL. NO.	ANSWER	REFERENCE NO.
1.	C	7.6.1

Sub Unit -7 Financial Regulators in India

Sl. No.	Topics
63	7.7.1 Financial Regulators in India

7.7.1 Financial Regulators in India

There are many financial institutions in India and we have many regulators for regulating them in order to assure the proper functioning of the financial system in our nation. There are five regulatory bodies in financial sector.

Reserve Bank of India (RBI)

Established in April, 1935 in Calcutta, the Reserve Bank of India (RBI) later moved to Mumbai in 1937. After its nationalization in 1949, RBI is presently owned by the Govt. of India. It has 19 regional offices, majorly in state capitals, and 9 sub-offices. It is the issuer of the Indian Rupee. RBI regulates the banking and financial system of the country by issuing broad guidelines and instructions.

Securities Exchange Board of India (SEBI)

Securities Exchange Board of India (SEBI) was established in 1988 but got legal status in 1992 to regulate the functions of securities market to keep a check on malpractices and protect the investors. Headquartered in Mumbai, SEBI has its regional offices in New Delhi, Kolkata, Chennai and Ahmedabad.

Insurance Regulatory and Development Authority of India (IRDA)

IRDAI is an autonomous apex statutory body for regulating and developing the insurance industry in India. It was established in 1999 through an act passed by the Indian Parliament. Headquartered in Hyderabad, Telangana, IRDA regulates and promotes insurance business in India.

Forward Market Commission of India (FMC)

Headquartered in Mumbai, FMC is a regulatory authority governed by the Ministry of Finance, Govt. of India. It is a statutory body, established in 1953 under the Forward Contracts (Regulation) Act, 1952. The commission allows commodity trading in 22 exchanges in India. The FMC is now merged with SEBI.

Pension Fund Regulatory and Development Authority (PFRDA)

Established in October 2003 by the Government of India, PFRDA develops and regulates the pension sector in India. The National Pension System (NPS) was launched in January 2004 with an aim to provide retirement income to all the citizens. The objective of NPS is to set up pension reforms and inculcate the habit of saving for retirement amongst the citizens.

Previous Year Question

Sub Unit – 7.7

June- 2019

1. **Which of the following is the predecessor of the IRDA Act, 1999?**

1. The Insurance Act, 1938
2. The Life Insurance Corporation Act, 1956
3. The Marine Insurance Act, 1963
4. The Pubic Liability Insurance Act, 1991

Answer with Reference

SL. NO.	ANSWER	REFERENCE NO.
1.	1	

June 2015

1. **The operations of banks and financial institutions are regulated by :**

a. The RBI Act 1934 only
b. The Banking Regulation Act 1949 only
c. Information Technology Act 2000 only
d. All of the above

Answer with Reference

SL. NO.	ANSWER	REFERENCE NO.
1.	D	7.7.1

Sub Unit-8 Financial sector reforms including financial inclusion

7.8.1 Financial sector reforms

Financial sector reforms includes the following sector reforms-

Banking Sector Reforms

Banking reforms consisted of a two-fold process. Firstly, the process involved recapitalisation of banks from government resources to bring them at par with appropriate capitalisation standards. On a second level, an approach was adopted replacing privatisation. Under this, increase in capitalisation has been brought about through diversification of ownership to private investors up to a cap of 49 per cent and thus keeping majority ownership and control with the government. The main idea was to increase the competition in the banking system by a gradual process and unlike other countries, banking reform in India, did not involve large-scale privatisation.

Capital Market Reforms

- To control the overall activities of capital market SEBI was established in the year 1988 and it got its legal status as an apex institution in capital market in the year 1992.
- All the share market intermediaries have been brought under the control of SEBI.
- A number of credit rating agencies and merchant bank were established.
- Foreign Institutional Investors (FIIs) have been allowed access to Indian Capital Market.
- Indian Companies have been permitted to access international Capital Market through Euro-equity shares.
- Over The Counter Exchange of India (OTCEI) and NSE had been established to spread electronic trading system country wide.
- The Banker to issue has been brought under the SEBI regulatory framework and a code of conduct has been issued.
- Appointment of Registrar has been made compulsory for the issue.
- Depository system has been introduced.

FOREX market reforms

- Transformation of total control exchange rate system to market based exchange rate system in the year 1993.
- Adoption of current account convertibility
- Authorised dealers of foreign exchange as well as banks have been given greater autonomy to carry out a wide range of activities and operations.
- Furthermore, the entry of new players has been allowed in the market. The capital account has become effectively convertible for non-residents but still has some reservations fore residents.

Other Financial Sectors Reforms

- Non-banking financial companies (NBFCs) including those involved in public deposit taking activities, have been brought under the supervision of the RBI.
- Development finance institutions (DFIs), NBFCs, urban cooperative banks, specialised term-lending institutions and primary dealers- all of these have been brought under the regulation of the Board for Financial Supervision.
- Insurance Regulatory and Development Agency (IRDA) was established to control and overall development of insurance business.

7.8.2 Financial Inclusion

Financial inclusion is the set of measures put in place to combat banking and financial exclusion. Financial Inclusion is described as the method of offering banking and financial solutions and services to every individual in the society without any form of discrimination. It primarily aims to include everybody in the society by giving them basic financial services without looking at a person's income or savings. Financial inclusion chiefly focuses on providing reliable financial solutions to the economically underprivileged sections of the society without having any unfair treatment. It intends to provide financial solutions without any signs of inequality. It is also committed to being transparent while offering financial assistance without any hidden transactions or costs.

7.8.2.1 Financial Inclusion Schemes in India

The Government of India has been introducing several exclusive schemes for the purpose of financial inclusion. These schemes intend to provide social security to the less fortunate sections of the society. After a lot of planning and research by several financial experts and policymakers, the government launched schemes keeping financial inclusion in mind. These schemes have been launched over different years. The list of the financial inclusion schemes in the country:

- Pradhan Mantri Jan Dhan Yojana (PMJDY)
- Atal Pension Yojana (APY)
- Pradhan Mantri Vava Vandana Yojana (PMVVY)
- Pradhan Mantri Mudra Yojana (PMMY)
- Pradhan Mantri Suraksha Bima Yojana (PMSBY)
- Sukanya Samridhi Yojana
- Jeevan Suraksha Bandhan Yojana
- Credit Enhancement Guarantee Scheme (CEGS) for Scheduled Castes (SCs)
- Venture Capital Fund for Scheduled Castes under the Social Sector Initiatives
- Varishtha Pension Bima Yojana (VPBY)

7.8.2.2 Objectives of Financial Inclusion

- Financial inclusion intends to help people secure financial services and products at economical prices such as deposits, fund transfer services, loans, insurance, payment services, etc.
- It aims to establish proper financial institutions to cater to the needs of the poor people. These institutions should have clear-cut regulations and should maintain high standards that are existent in the financial industry.
- Financial inclusion aims to build and maintain financial sustainability so that the less fortunate people have a certainty of funds which they struggle to have.
- Financial inclusion also intends to have numerous institutions that offer affordable financial assistance so that there is sufficient competition so that clients have a lot of options to choose from. There are traditional banking options in the market. However, the number of institutions that offer inexpensive financial products and services is very minimal.

Previous Year Question

Sub Unit – 7.8

June 2019

1**. New reform in Indian banking system include:**
(a) Digitization of bank operations
(b) Banking consolidation
(c) Borrowing from Government
(d) Agency work
Choose the correct option from the following:
1. (a) and (b)
2. (c) and (d)
3. (b), (d) and (c)
4. (a), (c) and (d)

Answer with Reference

SL. NO.	ANSWER	REFERENCE NO.
1.	1	7.8.1

July- 2018

1. **Match the items of List - II with the items of List - I and indicate the correct code :**

List - I	**List - II**
(a) Term finance	(i) Providing finance to new or existing industrial units for encouraging commercial application of technology/ expansion.
(b) Refinance	(ii) Delivering of banking services at affordable cost to the vast sections of disadvantaged and low income groups.
(c) Financial inclusion	(iii) Providing replenishment finance to eligible institutions for their loans to industrial concerns.
(d) Venture capital	(iv) Providing finance to the borrowers for expansion and modernization of plant and equipment.

Code :

	(a)	(b)	(c)	(d)
(1)	(i)	(ii)	(iii)	(iv)
(2)	(i)	(ii)	(iv)	(iii)
(3)	(iv)	(iii)	(ii)	(i)
(4)	(iv)	(iii)	(i)	(ii)

Answer with Reference

SL. NO.	ANSWER	REFERENCE NO.
1.	3	7.8.2

Sub Unit-9
Digitisation of banking and other financial services: Internet banking; mobile banking; Digital payments systems

Sl. No.	Topics
68	7.9.1 E- Banking
69	7.9.1.1 E- Banking Products and Services
70	7.9.1.2 Core Banking Solution (CBS)
71	7.9.1.3 Advantages of e-banking

7.9.1 E- Banking

Electronic banking is defined as the automated delivery of new and traditional banking products and services directly to customers through electronic, interactive communication channels. 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.

Electronic banking can also be defined as a variety of the following platforms.

- Internet banking or online banking
- Telephone banking
- TV based banking
- Mobile phone banking
- Web based banking
- Personal computer (PC) banking,
- Virtual banking,
- Home banking,
- Remote electronic banking,

A visible presence of **e- banking was evident to the customers since 1981**, with the introduction of the Automated Teller Machine (ATM).

7.9.1.1 E- Banking Products and Services

Indian banks commonly offer the following e-banking products and services to the customers

1. Internet Banking

Net Banking, also known as online banking or Internet Banking, is an electronic payment system. It allows you to conduct many different types of transactions through the internet from the comfort of your home. Be it transferring funds to another bank account or checking the transaction statements, you can do them all and much more with the help of Internet Banking.

2**. Mobile Banking**

Mobile banking refers to perform the online banking transactions using mobile or smart phone.

3. Tele phone Banking

Telephone Banking is an automated service that allows you to access your account information and perform routine transactions from a touch-tone telephone. Tele-banking requires you to access a landline number, and make your choices by pressing the required number, till you reach a phone-banking executive. Identity is confirmed through a question like address, PAN or Date of Birth details. Some may need a T-Pin to transact. The lines are usually busy, and it takes a lot of patience to hold the line.

4. Automated Teller machines (ATMs)

ATM means neither “avoids travelling with money” nor “any time money”, but certainly implies both. ATM was first well- known machine to provide electronic access to customers. It is operated by plastic card with its special features. ATMs perform a number of banking functions- such withdrawing cash from one’s account, making balance enquiries and transferring money from one account to another using a plastic, magnetic-stripe card and personal identification number issued by the financial institution. In India, HSBC set the trend and set up the first ATM machine here in 1987.

5. Smart Card

A smart card is basically a plastic card with a chip. The chip contains information. In terms of banking, it contains information like your account details. So, all our debit cards as well as credit cards are smart cards. Gift cards are also available with banks these days. Gift cards are mostly like our ATM cards of an appropriate value of money. These are smart cards as well.

6. Debit Card

A **debit card** (also known as a **bank card**, **plastic card** or **check card**) is a plastic payment card that can be used instead of cash when making purchases. It is similar to a credit card, but unlike a credit card, the money is immediately transferred directly from the cardholder's bank account when performing any transaction. A Debit card is basically an ATM card. By using Debit Card account holders can transfer, withdraw, deposit money from his account and the holders can also purchase goods or services with this card.

7. Credit Card

A **credit card** is a payment card issued to users (cardholders) to enable the cardholder to pay a merchant for goods and service based on the cardholder's promise to the card issuer to pay them for the amounts plus the other agreed charges A credit card is the most common way to access a line of credit. Usually issued by a bank or financial services company, credit cards allow account holders to make purchases on credit without having to put up cash at the point of sale. Instead, the charges accrue as a balance that must be paid off on a monthly billing cycle, giving the buyer more time to get the cash together. The amount of a credit card line of credit, usually called a credit limit, is determined by the card holder’s credit score and income.

8. E-cheque

An electronic version or representation of a paper cheque is a called e-cheque. The account holder writes an e-cheque using a computer or other type of electronic device and transmits the e-cheque to the payee electronically. Like paper cheques, e-checks are signed by the payer and endorsed by the payee. Rather than handwritten or machine-stamped signatures, however, e-checks are affixed with digital signatures, using a combination of smart cards and digital certificates. The payee deposits the e-check, receives credit, and the payee's bank clears the e-check to the paying bank. The paying bank validates the e-check and then charges the cheque writer's account for the cheque.

9. E-wallet

E-wallet is a type of electronic card which is used for transactions made online through a computer or a smartphone. Its utility is same as a credit or debit card. An E-wallet needs to be linked with the individual’s bank account to make payments. E-wallet is a type of pre-paid account in which a user can store his/her money for any future online transaction. An E-wallet is protected with a password. With the help of an E-wallet, one can make payments for groceries, online purchases, and flight tickets, among others.

10. Unified Payments Interface (UPI)

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.

11. Electronic Clearing System (ECS)

Electronic Clearing System (ECS) is an electronic method of fund transfer from one bank account to another. It is generally used for bulk transfers performed by institutions for making payments like dividend, interest, salary, pension, etc. ECS can also be used to pay bills and other charges such as payments to utility companies such as telephone, electricity, water, or for making equated monthly instalments payments on loans as well as SIP investments. ESC can be used both for ECS debit and ECS credit.

12. Electronic Fund Transfer

i) Real Time Gross Settlement (RTGS)

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.

ii) National Electronic Funds Transfer (NEFT)

The National Electronic Fund Transfer is perhaps one of the most common ways of transferring money online from one bank account to another. In this method, there is no cap on the amount of money that can be transferred. However, individual banks may have set their own limits. Also, do remember that each transfer cannot exceed Rs 50,000. To initiate a NEFT transfer, you must have the bank IFSC code, along with details such as bank account number, bank branch, and account holder name, among other details.

iii) Immediate Payment Service (IMPS)

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.

iv) SWIFT (The Society for Worldwide Interbank Financial Telecommunication)

The Society for Worldwide Interbank Financial Telecommunication (SWIFT) is the network that banks and other financial institutions use for transferring information securely. Most major financial institutions use SWIFT, as it is considered the gold standard for reliable and secure financial messaging.

Originally founded in the 1970s, SWIFT was created when banks around the world decided to collaborate to solve the problem of **cross-border payments**. Today, the globally-owned cooperative is connected to over 11,000 institutions around the world and is connected to more than 200 countries.

7.9.1.2 Core Banking Solution (CBS)

It is a networking of bank branches, which allows customers to manage their accounts, and use various banking facilities from any part of the world. In simple term, there is no need to visit your own branch to do banking transactions. You can do it from any location, any time. You can enjoy banking services from any branch of the bank which is on CBS network regardless of branch you have opened your account. For the bank which implements CBS, the customer becomes the bank's customer instead of customer of particular branch. In Core banking, the all branches access banking applications from centralized server which is hosted in secured data center.

7.9.1.3 Advantages of e-banking

- The cost of operation per unit of services is lower for banks.
- Offers convenience to customers since they are not required to go to the bank's facilities.
- There is a very low incidence of errors.
- The customer can obtain funds at any time from ATMs.
- Credit cards and debit cards allow customers to get discounts at points of sale.
- The customer can easily transfer the funds from one place to another place electronically.

Previous Year Question

Sub Unit – 7.9

June 2019

1. **Which of the following are included in digital payment system?**
(a) RTGS (b) Demand draft
(c) NEFT (d) Cheque
Choose the correct option from the following:
1. (a), (c) and (d)
2. (b) and (d) only
3. (a) and (c) only
4. (b), (c) and (d)

2. **Which one of the following is used for international money transfer?**
1. RTGS
2. NEFT
3. SWIFT
4. DD

Answer with Reference

SL. NO.	ANSWER	REFERENCE NO.
1.	3	7.9.1.1
2.	3	7.9.1.1

Jan.- 2017

1.**Which of the following are the forms of e - banking ?**
Select the correct code.
(a) Internet Banking
(b) Telephone Banking
(c) Electronic Cheque Conversion
(d) Electronic Bill Payment
(e) Direct Fund Transfer Through RTGS
Code :
(1) (a), (c) and (d)
(2) (a), (b), (c) and (d)
(3) (b), (c) and (d)
(4) (a), (b), (c), (d) and (e)

Answer with Reference

SL. NO.	ANSWER	REFERENCE NO.
1.	4	7.9.1.1

Nov. -2017

1. Assertion (A) : The future will see mostly the electronic money clearance through satellite networking.

Reasoning (R) : RBI is encouraging e-banking.

Codes :

(1) (A) is true but (R) is false.

(2) (A) is false but (R) is true.

(3) Both (A) and (R) are true and (R) is the correct explanation of (A).

(4) Both (A) and (R) are true but (R) does not support (A).

Answer with Reference

SL. NO.	ANSWER	REFERENCE NO.
1.	3	7.9.1.1

Sept. 2016

1. **E-Banking is also referred to as**
(a) Web-based Banking
(b) Branchless Banking
(c) Virtual Banking
(d) Internet Banking
(e) Western Banking
(f) Neo-classical Banking
Codes :
(1) (a), (b), (c) and (d)
(2) (a), (b), (c) and (e)
(3) (a), (c), (d) and (f)
(4) (a), (c), (d) and (e)

Answer with Reference

SL. NO.	ANSWER	REFERENCE NO.
1.	1	7.9.1

July 2016

1. **Banking on telephone service includes :**
(i) Automatic balance voice out
(ii) Inquiry all term deposit account
(iii) Direct cash withdrawal
(iv) Utility bill payment
(v) Voice out last five transactions
Codes :
(1) (i), (ii), (iii) and (v)
(2) (i), (ii), (iv) and (v)
(3) (ii), (iii), (iv) and (v)
(4) All (i), (ii), (iii), (iv) and (v)

2.**If you need to transfer money to another person through internet, which of the following method you could use ?**
(1) Financial cyber mediary
(2) Electronic cheque
(3) Electronic bill presentation and payment
(4) All of the above

Answer with Reference

SL. NO.	ANSWER	REFERENCE NO.
1.	2	7.9.1.1
2.	4	7.9.1.1

Dec.2015

1. **'SWIFT' stands for:**

a. Society for Worldwide Inter-bank Fund Transfer
b. Society for Worldwide Inter-bank Fast Transmission
c. Society for Worldwide Inter-bank Financial Telecommunications
d. None of the above

Answer with Reference

SL. NO.	ANSWER	REFERENCE NO.
1.	C	7.9.1.1

June 2015

1. **To operationalise online, internet, mobile banking, debit card and credit card tools, some of the essential ingredients are :**

a. Compliance with the Information Technology Act 2000
b. Satellite connection
c. Selection of a portal and server
d. All of the above

Answer with Reference

SL. NO.	ANSWER	REFERENCE NO.
1.	4	7.9.1.1

Sub Unit-10

Insurance: Types of insurance- Life and Non-life insurance; Risk classification and management; Factors limiting the insurability of risk; Re-insurance; Regulatory framework of insurance- IRDA and its role

7.10.1 Concept of Insurance

Insurance is a legal contract between two parties –individual or entity who receives financial protection (referred to as insured) and the insurance company that promises to compensate the losses (referred to as insurer) in return for the money (premium) paid by the insured. In simple words, insurance provides protection. Basically, the concept of insurance is to spread the risk of an individual or an entity among larger society. Insurance is a risk management mechanism wherein you transfer your risk to the insurance company by paying them the premium.

7.10.1.1 Some Important terms related to Insurance

Insured: The party or the individual who seeks protection against a specified task and entitled to receive payment from the insurer in the event of happening of stated event is known as insured. An insured is normally in insurance policy holder.

Insurer

The party who promises to pay indemnity the insured on the happening of contingency is known as insurer. The insurer is an insurance company.

Reinsurance

Reinsurance is a method where by the original insurer transfer all or part of risk he has assumed to another company or companies with the object of reducing his own commitment to an reducing his own commitment to an amount that he can bear for his own account commensurate with his financial resources in the event of loss.

Double Insurance

Double insurance implies that subject matter is insured in two or more insurance companies (insurers) and the total sum insured exceeds the actual value of subject matter. In other words, the same subject matter is insured in more than one insurer.

Under Insurance

In case of under insurance, insurance cover has been taken lower than the value of the insured risk.

Over Insurance

In case of over insurance, insurance cover has been taken for the value which exceeds the actual cash value of the insured risks.

Insurable interest: Insurable interest is the prerequisite for every insurance policy. A person or entity seeking insurance has an insurable interest in the subject matter when any damage or loss would impact in financial hardship

Beneficiary: An individual who is eligible to receive the insurance proceeds if the insured person dies

Sum insured/Sum Assured: Sum insured is the maximum amount that the insurance company will pay you if the insured event takes place. The term Sum Insured is applicable in case of Life Insurance and the term Sum Assured is applicable in case of General Insurance.

Surrender Value

If the policyholder decides to discontinue the plan before the maturity age, the life insurance company pays an amount to the policyholder, this is called Surrender Value.

Revival Period

If the policyholder does not pay the premium even during the grace period, the policy becomes lapses. However, if the policyholder still wants to continue, the insurance company provides an option of re-activating the lapsed policy. This must be done within a specific period of time after the grace period ends. This specified period is known as a revival period.

Free-look Period:

It is applicable to all new life insurance policies purchased. Free-look period is a time frame during which one may choose to return the purchased policy.

7.10.1.2 Types of Insurance

Insurance can be broadly be classified as life insurance and general insurance. Life Insurance again can be classified as Term Insurance Plan, endowment plans, Pension Plan, Whole life insurance plan and Unit Linked Insurance Plan (ULIP), Child Plan. On the other hands general insurance can be classified as Motor Insurance, Health Insurance, Travel Insurance, Marine Insurance, Home Insurance, Fire Insurance, etc.

Life and Non-Life/General Insurance

Life Insurance

Life insurance is a contract that offers financial compensation in case of death or disability. Some life insurance policies even offer financial compensation after retirement or a certain period of time. Life insurance, thus, helps you secure your family’s financial security even in your absence. You either make a lump-sum payment while purchasing a life insurance policy or make periodic payments to the insurer. These are known as premiums. In exchange, your insurer promises to pay an assured sum to your family in the event of death, disability or at a set time.

Non-Life/General Insurance

A general insurance is a contract that offers financial compensation on any loss other than death. It insures everything apart from life. A general insurance compensates you for financial loss due to liabilities related to your house, car, bike, health, travel, etc. The insurance company promises to pay you a sum assured to cover damages to your vehicle, medical treatments to cure health problems, losses due to theft or fire, or even financial problems during travel.

Health Insurance

This type of general insurance covers the cost of medical care. It pays for or reimburses the amount you pay towards the treatment of any injury or illness.

Motor Insurance

Motor insurance is for your car or bike what health insurance is for your health. It is a general insurance cover that offers financial protection to your vehicles from loss due to accidents, damage, theft, fire or natural calamities.

Travel insurance

Travel insurance compensates you or pays for any financial liabilities arising out of medical and non-medical emergencies during your travel abroad or within the country.

Home Insurance

Home insurance is a cover that pays or compensates you for damage to your home due to natural calamities, man-made disasters or other threats. It covers liabilities due to fire, burglary, theft, flood, earthquakes, and sabotage. It not only offers financial protection to your home, but also takes care of the valuables inside the property.

Fire Insurance

Fire insurance pays or compensates for the damages caused to your property or goods due to fire. It covers the replacement, reconstruction or repair expenses of the insured property as well as the surrounding structures. It also covers the damages caused to a third-party property due to fire. In addition to these, it takes care of the expenses of those whose livelihood has been affected due to fire.

7.10.2 Regulatory framework of Insurance

IRDA and its role

Before, IRDA Act, came into force insurance sector was regulated by The Insurance Act, 1938. Insurance Regulatory and Development Authority of India Act was passed by the Parliament in the year December 1999.The Act received President's approval in the year January 2000. The Act intends to protect the interest of the insurance policy holders. It also aims to encourage and ensure the systematic growth of the insurance industry. The Insurance Regulatory and Development Authority is a statutory body formed by the Insurance Regulatory and Development Authority of India Act, 1999.

Role of IRDA

- To protect the interest of and ensure just treatment to insurance policy holders.
- To encourage and ensure the systematic growth of the insurance industry so as to benefit the common man and help in bringing economic growth.
- To set, promote, monitor and apply high standards of integrity, fair dealing, financial viability and capability of those it regulates.
- To ensure clarity, preciseness, transparency while dealing with the insurance policy holder. The Authority ensures that correct information about the products and services is passed on to the policy holders along with making them aware of their responsibilities.
- To provide dispute resolution mechanism and ensure speedy settlement of genuine claims. The Authority must check insurance scams and other misconducts.
- To take suitable steps against circumstances where set standards do not prevail or inappropriately enforced.
- To bring about the optimal amount of self-regulation in day-to-day activities of the industry reliable with the requirements of the prudential regulation.
- IRDA monitors the investment of funds by insurance companies and governs the maintenance of margin of solvency
- It also judges the disputes between insurers and intermediaries or insurance intermediaries
- It supervises the functioning of the Tariff Advisory Committee
- IRDA specifies the percentage of premium income of the insurer to finance schemes for promoting and regulating professional organizations referred to in clause (f)
- It specifies the percentage of life insurance and general insurance business to be undertaken by the insurer in the rural or social sector
- It specifies the requisite qualifications, code of conduct and the practical training required for insurance intermediaries and agents
- IRDA makes certain that the code of conduct is followed by surveyors and loss assessors
- The autonomous body promotes efficiency in the conduct of insurance business

Previous Year Question

Sub Unit – 7.10

June 2019

1**. Which of the following is the predecessor of the IRDA Act, 1999?**
1. The Insurance Act, 1938
2. The Life Insurance Corporation Act, 1956
3. The Marine Insurance Act, 1963
4. The Pubic Liability Insurance Act, 1991

Answer with Reference

SL. NO.	ANSWER	REFERENCE NO.
1.	1	7.10.2