**MODULE A – INDIAN FINANCIAL SYSTEM**

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Unit 1: Indian Financial System – An Overview

Financial Market

Financial system

Financial system a network of financial institutions (COMMERCIAL BANKS, BUILDING SOCIETIES, etc.) and markets (MONEY MARKET, STOCK MARKET), dealing in a variety of financial instruments BANK DEPOSITS, STOCKS and SHARES, etc., which are engaged in money transmission activities and the provision of LOAN and CREDIT facilities. The financial institutions and markets occupy a key position in the economy as intermediaries in channelling savings and other funds to borrowers and investors. In doing this one of their main roles is to reconcile the different requirements of savers and borrowers, thereby facilitating a higher level of saving and investment in the economy than would otherwise be the case.
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<td>4) Regulation insurance brokers including agencies both individual and Bank PENSIONS</td>
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<td>5) Regulating monetary instruments (CRR, SLR, BANK RATE, REPO RATE, MSF)</td>
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</table>

**Central Bank Authority**

**i) Commercial Bank:** A commercial bank is a type of bank that provides services such as accepting deposits, making business loans, and offering basic investment products that is operated as a business for profit. Public Sector Bank, Private sector Bank, Foreign Bank etc ...

**ii) Non- Banking Financial Companies (NBFC):** A Non – Banking Financial Corporation is a company incorporated under the **Companies Act 2013 or 1956** which is engaged in the business of Loans and Advances, Acquisition of stocks, equities, debt etc issued by the government or any local authority. The main objective of this type of a company is to accept deposits under any scheme or manner.
According to section 45-I (c) of the RBI Act, a Non – Banking Company carrying on the business of a financial institution will be an NBFC. It is governed by the Ministry of Corporate Affairs as well as the Reserve Bank of India.

The following NBFC’s are not required to obtain any registration with the Reserve Bank of India:

- Core Investment Companies – (assets are less than 100 crore or public funds not taken)
- Merchant Banking Companies
- Companies which are engaged in the business of stock-broking
- Housing Finance Companies
- Companies engaged in the business of Venture Capital.
- Insurance companies holding a certificate of registration issued by IRDA.
- Chit Fund Companies as defined in the Sec 2 clause (b) of the Chit Fund Act, 1982
- Nidhi Companies

iii)Primary Dealers (PDs): Primary dealers are registered entities with the RBI who have the license to purchase and sell government securities. They are entities who buys government securities directly from the RBI (the RBI issues government securities on behalf of the government), aiming to resell them to other buyers.

iv)Financial Institutions (FIs): Financial institutions are companies in the financial sector that provide a broad range of business and services including banking, insurance, and investment management. Governments of the country consider it important to oversee and to regulate financial institutions as they play an integral part in the economy of the country.

FIs are development financial institutions which provide long term-funds for industry and agriculture.

v)Cooperative Banks: Cooperative credit society in 1904 led to formation of cooperative banks. Presently, registered under Cooperative Society Act, 1965 and regulated by NABARD & RBI. These banks run for social welfare and not for profit maximization.

They are owned and operated by members itself to provide financial service to agriculturist and small businessmen.

Their main function is to get the deposit from members and public and grant loans to farmers (even farmer who is not member) and small industrialists in both rural and urban area.
vi) Payment and Settlement system: They are covered by the Payment and Settlement Systems Act, 2007 (PSS Act), legislated in December 2007 and regulated by the Reserve Bank of India and the Board for Regulation and Supervision of Payment and Settlement Systems. India has multiple payments and settlement systems, both gross and net settlement systems.

vii) Management of Government Debt: Sovereign debt management is the process of establishing and executing a strategy for managing the government's debt in order to raise the required amount of funding, achieve its risk and cost objectives, and to meet any other sovereign debt management goals the government may have set, such as developing

viii) Bankers to Government: The RBI acts as banker to the government the Central as well as state governments. As such, it transacts all banking business of the government, which involves the receipt and payment of money on behalf of the government and carrying out of its exchange, remittance and other banking operations (Bonds and Treasury Bill).

ix) Lender of Last resort to banks: The Central Bank provides Liquidity supports on a temporary basis through the facility of repurchase (REPO) of security to banks to meet their short-term liquidity requirements.

x) Cash Reserve Ratio (CRR): Section 42(I) of RBI Act 1934, cash reserve ratio (CRR) is the amount of funds that all scheduled Commercial Banks (SCBs) are required to maintain with RBI.

The cash reserve is either stored in the bank’s vault or is sent to the RBI. Banks do not get any interest on the money that is with the RBI under the CRR requirements.

Under Section 42 of RBI Act 1934

Minimum- 3%

Note: The central bank, in its March 27 Developmental and Regulatory Policies Statement, had reduced the requirement of minimum daily CRR balance maintenance from 90 per cent to 80 per cent effective from the first day of the reporting fortnight beginning March 28, 2020. This one-time dispensation was initially available up to June 26, 2020.

xi) Statutory Liquidity Ratio (SLR): Statutory Liquidity Ratio or SLR is a minimum percentage of deposits that a commercial bank has to maintain in the form of liquid cash, gold or other securities. It is basically the reserve requirement that banks are expected to keep before offering credit to customers. ... The SLR is fixed by the RBI.

Minimum- 0%

Maximum- 40%
**Equity and Debt Market**

i) **Stoke Exchanges**: A stock exchange, securities exchange or bourse is a facility where stockbrokers and traders can buy and sell securities, such as shares of stock and bonds and other financial instruments.

ii) **Brokers**: A broker is an individual or firm that charges a fee or commission for executing buy and sell orders submitted by an investor. A broker also refers to the role of a firm when it acts as an agent for a customer and charges the customer a commission for its services.

iii) **Equity and Debt Raisers**: "Debt" involves borrowing money to be repaid, plus interest, while "equity" involves raising money by selling interests in the company. Essentially you will have to decide whether you want to pay back a loan or give shareholders stock in your company.

iv) **Investment Bankers (Merchant Bankers)**: An Investment bank is a financial services company or corporate division that engages in advisory-based financial transactions on behalf of individuals, corporations, and governments.

v) **Foreign institutional investors**: A foreign institutional investor (FII) is an investor or investment fund registered in a country outside of the one in which it is investing. Institutional investors most notably include hedge funds, insurance companies, pension funds, and mutual funds.

vi) **Custodians**: A custodian is a financial institution that holds customers' securities for safekeeping in order to minimize the risk of their theft or loss. A custodian holds securities and other assets in electronic or physical form.

vii) **Depositories**: A depository is a building, office, or warehouse in which something is deposited for storage or safeguarding. Depositories may be organizations, banks, or institutions that hold securities and assists in the trading of securities.

ix) **Mutual Funds**: A mutual fund is a company that pools money from many investors and invests the money in securities such as stocks, bonds, and short-term debt. The combined holdings of the mutual fund are known as its portfolio. Investors buy shares in mutual funds.

x) **Markets like registrars**: The registrar accounts for all issued and outstanding shares, as well as the number of shares owned by each individual shareholder.

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**Insurance Regulatory and Development Authority**

i) **Multi Commodity Exchange of India (MCX)**: The Multi Commodity Exchange of India Limited (MCX) is India's first listed exchange, is a state-of-the-art, commodity derivatives exchange
that facilitates online trading of commodity derivatives transactions, thereby providing a platform for price discovery and risk management.

ii) Let us sum up: Sum insured is the maximum value for a year that your Insurance Company can pay in case you are hospitalized. Any amount above and beyond the sum insured will have to be taken out from your own pocket.

**Unit 2- Banking Regulation**

The Reserve Bank of India (RBI) is India’s central bank, also known as the banker’s bank. The RBI controls monetary and other banking policies of the Indian government. 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.

**Establishment of Reserve Bank of India**

The Reserve Bank is fully owned and operated by the Government of India.

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

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

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
Legal Framework

The Reserve Bank of India comes under the purview of the following Acts:

- Reserve Bank of India Act, 1934
- Public Debt Act, 1944
- Government Securities Regulations, 2007
- Banking Regulation Act, 1949
- Foreign Exchange Management Act, 1999
- Credit Information Companies(Regulation) Act, 2005
- Payment and Settlement Systems Act, 2007

Objectives

The primary objectives of RBI are to supervise and undertake initiatives for the financial sector consisting of commercial banks, financial institutions and non-banking financial companies (NBFCs).

Some key initiatives are:

- Restructuring bank inspections
- Fortifying the role of statutory auditors in the banking system
Major 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.

Direct Instruments:

- CRR
- SLR

Indirect Instruments:

Liquidity Adjustment Facility (LAF): A liquidity adjustment facility (LAF) is a tool used in monetary policy, primarily by the Reserve Bank of India (RBI), that allows banks to borrow money through repurchase agreements (repos) or for banks to make loans to the RBI through reverse repo agreements.

Repo/Reverse Repo Rate: Repo or repurchase rate is the benchmark interest rate at which the RBI lends money to all other banks for a short-term. When the repo rate increases. Reverse Repo Rate (RRR) Reverse Repo rate is the short-term borrowing rate at which RBI borrows money from other banks. The Reserve Bank of India uses this method to reduce inflation when there is excess money in the banking system. Borrowing from RBI becomes more expensive and hence customers or the public bear the outcome of high-interest rates.

Open Market Operation (OMO): Open market operations is a tool that the RBI uses to smoothen liquidity conditions through the year and regulate money supply in the economy. Open market operations is the sale and purchase of government securities and treasury bills by RBI or the central bank of the country. Since 2012, RBI has been using this instrument as a pure LAF, liquidity instrument.

Marginal Standing Facility (MSF): Marginal Standing Facility is a new Liquidity Adjustment Facility (LAF) window created by Reserve Bank of India in its credit policy of May 2011. MSF is the rate at which the banks are able to borrow overnight funds from RBI against the approved government securities.

Bank Rate: A bank rate is the interest rate at which a nation’s central bank lends money to domestic banks, often in the form of very short-term loans. Managing the bank rate is a method by which central banks affect economic activity.
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.

Currency Issuer

- Issues, exchanges or destroys currency and not fit for circulation.
- Provides the public adequately with currency notes and coins and in good quality.

Developmental role

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

Related Functions

- Provides banking solutions to the central and the state governments and also acts as their banker.
- Chief Banker to all banks: maintains banking accounts of all scheduled banks.

Banker to Banks

- Enables smooth and swift clearing and settlements of inter-bank transactions.
- Provides efficient means of funds transfer for all banks.
- Enables banks to maintain their accounts with RBI for statutory reserve requirements and maintenance of transaction balances.

Regulatory restrictions on lending

In terms Banking Regulation Act, 1949, RBI provides a framework of the rules, regulations, and instructions with regard to bank lending. Accordingly it has issued following directions to scheduled commercial banks on statutory and other restrictions on loans and advances.
• A bank cannot grant any loans and advances on the security of its own shares.
• Enter into any commitment for granting any loan or advance to or on behalf of- (a) any of its Directors,(b) any firm in which any of its Directors is interested as Partner, Manager, Employee or Guarantor.
• **Under section 19 of Banking Regulation Act 1949,** a bank cannot hold shares in a company as (a) **pledgee or mortgagee in excess 30 percent of paid up** of that company or 30 percent of bank’s paid capital and reserves whichever is less. (b) in the management of which Managing Director or Manager of the bank is interested.
• Bank's aggregate investment in shares, certificate of deposits, **bonds etc. shall not exceed the 40 percent of banks owned funds** as at the end of previous year.
• A bank cannot grant credit facilities against Certificate of deposits, Term deposits issued by other banks or money market mutual funds.
• Banks shall adhere to selective credit control directives of RBI while releasing loans against sensitive commodities.
• Banks should not sanction a new or additional facility to borrowers appearing in RBI’s list of Wilful defaulters for a **period of 5 years from** the date of publication of the list by RBI.
• There are certain restrictions on Grant of Loans & Advances or award contracts to Officers and Relatives of Officers of Banks. No officer or any Committee comprising, inter alia, an officer as member, shall, while exercising powers of sanction of any credit facility, sanction any credit facility to his/her relative. Such a facility shall ordinarily be sanctioned only by the next higher sanctioning authority. Credit facilities sanctioned to senior officers of the financing bank should be reported to the Board.

**Inclusion of Urban Co-operative banks in the Second Schedule to the Reserve Bank of India Act 1934**

• The Reserve Bank today allowed **urban cooperative banks (UCBs)** with total deposits of over **Rs 750 crore to graduate to scheduled bank category.**
• If UCBs fulfill certain listed criteria, it will eligible for inclusion in the second schedule, RBI said in a notification.
• All the public sector banks, private sector banks, foreign banks, regional rural banks are part of the second schedule.
• As per the government’s notification, with effect from **April 01, 2013,** only those primary co-operative banks whose demand and time liabilities are not less than **Rs 750 crore would** be treated as a ‘financial institution’ for the purpose Sub-Clause
(iii) of clause (a) of Sub-section (6) of section 42 of RBI Act 1934, i.e., for the purpose of inclusion of UCBs in the Second Schedule of the Reserve Bank of India Act, 1934.

- UCBs desirous of seeking inclusion in the schedule should fulfill certain other criteria including continuous net profit for the previous three years, capital adequacy ratio of 12 per cent and gross non-performing assets of less than 5 per cent.
- Besides, the bank needs to comply with Cash Reserve Ratio and Statutory Liquidity Ratio requirements and there should be major regulatory and supervisory concerns.
- Such UCBs can submit their application along with relevant documents to the Regional Office concerned of Urban Banks Department.

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- Module Wise Mock- 250 Questions  
- Full length Mock 5- 600 Questions  
(Each Mock 120 Q)  
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Unit-3: Retail banking, Wholesale and International Banking

Retail Banking

Retail banking, also known as Consumer banking, refers to the offering of banking services to retail customers instead of institutional customers, such as companies, corporations and/or financial institutions.

Today’s Retail banking sector is characterized by three basis features:

- Multiple products (deposits, credit cards, insurance, investments and securities)
- Multiple channels of distribution (call centre, branch, Internet and Kiosk)
- Multiple customer groups (Consumer, small business and corporate)

Retail Products

The Typical products offered in the Indian retail banking segment are:

Retail Deposit Products

- Saving Bank Account
- Recurring Deposit Account
- Current Deposit Account
- Term Deposit Account
- Zero Balance Account for salaried class people
- Basis Saving Bank Deposit Account (BSBDA) for the common man
- Senior Citizen Deposit Account, etc.

Retail Loan Products

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

Retail Services

• Safe Deposit lockers
• Depository services
• Bancassurance Products etc.

Drives of Retail Banking in India

Appreciable Growth Rate

Economic prosperity and the following escalation in purchasing power have given a boost to a consumer boom. From 1992 India’s economy nurtured at an average rate of 6.8% and continue to grow at a comfortable rate.

Changes in demographic profile

Change in consumer demographics shows vast potential for growth in consumption both qualitatively and quantitatively. It has been forecasted that BRIC nations has bright future, in which India’s demographic advantage will have a key role.

Today the average age of borrower has dropped from 40 years about five years ago to, now, an estimated 30 years. In the future the average age is predicted to reduce further and hence it will indicate well for the housing finance market in terms of increased borrowers.

Decline in Average house costs

There has been a decline in average house cost to annual income ratio by 4-5 times from high of 11-14 a decade ago. This has also lead to an affordable EMI as a percentage of monthly income.

Aggressive Lending by Banks
Banks found a respite in housing loans as a means to deploy funds on back of lull in credit off take by the corporate segment. To add to that the segment called for lower risk weights, provided attractive spread and has lower level of delinquency.

**Tax Breaks**

The recent budgets provided for several tax and fiscal enticements for deploying funds in the housing sector. The Reserve Bank of India (RBI) had also addressed commercial banks to allocate at **least 3 per cent of their incremental deposits in housing loans**. At the same time the policy of the Reserve Bank of India about the inclusion of Mortgage backed securities as a part of priority sector lending for banks and reducing the risk-weight on home loans from 100 per cent to 50 per cent made the sector more attractive for the banks.

** Others growth Drivers**

Technological factors played a chief role. Convenience banking in the form of debit cards, internet and phone-banking, anywhere and anytime banking has attracted many new consumers into the banking field. **Technological innovations connecting to increasing use of credit / debit cards, ATMs, direct debits and phone banking** has added to the development of retail banking in India.

Treasury income of the banks, which had reinforced the bottom lines of banks for the past few years, has been on the decline during the last two years. In such a situation, retail business offers a good vehicle of profit maximization.

Drop in interest rates have also backed to the growth of retail credit by creating the demand for such credit.

**Wholesale and International Banking**

**What is Wholesale Banking**

Wholesale banking refers to the complete banking solution provided by the merchant banks to the large scale business organizations and the government agencies or institutions. To avail the facility of wholesale banking, the companies need to possess a strong **financial statement and operate on a large scale**. Usually, **multinational companies are the clients of wholesale banking**.

**Wholesale Banking Product**

**Fund-based Services**

(i) Term lending (ii) Short –term Finance (iii) Working Capital Finance
(iv) Bill Discounting (v) Structured Finance (vi) Export Credit

**Non-fund based Services**
(i) Bank Guarantee (ii) Letter of credit (iii) Collection of Bills and Documents

Value-added services


Internet Banking Services

(i) Payment Gateway Services (ii) Corporate Internet Banking (iii) Supply Chain Management (iv) Supply Chain Partners

**What is International Banking**

An international bank is a financial entity that offers financial services, such as payment accounts and lending opportunities, to foreign clients. These foreign clients can be individuals and companies, though every international bank has its own policies outlining with whom they do business.

**Example:** Suppose Microsoft, an American company is functioning in London. It is in need of funds to meet its working capital requirements. In such scenario, Microsoft can avail the banking services in form of loans, overdraft or any other financial service through banks in London. Here, the residential bank of London shall be giving its services to an American company.

**Need of Exporters in International Banking**

- Export Packing Credit
- Export Bill Negotiation
- Export Bill Purchase and Discounting
- Export Bill Collection Services
- Bank Guarantees
- Rupees Advance against Export Bills

- Export Latter of Credit Advising
- Export Latter of Credit Confirmation
- Supplier’s Credit
Need of Importers in International Banking

- Import Collection Bill Services
- Direct Import Bills
- Advance Payment towards Imports
- Import letters of Credit
- Arranging for Buyer’s and Supplier’s Credit
- Bank Guarantees

Remittance Service

**EEFC Account Service:** Bank provide facilities to maintain an Exchange Earners Foreign Currency in all permitted currencies.

**Receipt of foreign Inward Remittances Services:** Banks receive from aboard and credit them to the Indian beneficiaries accounts.

**Payment Services to Abroad (Outward Remittances):** Banks as Authorised Dealers in foreign Exchange provide remittance facilities in foreign to any country for any permitted Purpose up the limits permitted by RBI.

**UNIVERSAL Banking**

What is a Universal bank? Definition and examples

A Universal bank is a bank that combines the three main services of banking under one roof. The three services are wholesale banking, retail banking, and investment banking. In other words, it is a retail bank, a wholesale bank, and also an investment bank. As well as being able to offer an all-encompassing service, universal banks can reap the synergies that exist when they operate in the three services simultaneously.

**For example:** BNP Paribas, Deutsche Bank, Morgan Stanley, and JP Morgan Chase are universal banks. Citigroup, Bank of America, UBS, Credit Suisse, HSBC, and Barclays are also universal banks.

**Universal Banking in India**

Basically Universal Banking is like a one stop shop where all financial products are available for customers. From core banking to asset management, wealth management to risk management, mutual funds to Retails, home loans and personal loans.
Previously RBI has encouraged universal banking in India, however, with the 2008 financial market collapse and too big to fail approach, the concept and idea of getting into different businesses which aren't profitable is not gathering steam.

From an Indian perspective I would say ICICI Bank and SBI are India centered, would be considered as universal bank operating in India.

**American Depository Receipt and Global Depository Receipt**

**Definition of ADR**

American Depository Receipt (ADR), is a negotiable certificate, issued by a US bank, denominated in US$ representing securities of a foreign company trading in the United States stock market. The receipts are a claim against the number of shares underlying. ADR’s are offered for sale to American investors. By way of ADR, the US investors can invest in non-US companies. The dividend is paid to the ADR holders, is in US dollars.

**Definition of GDR**

GDR or Global Depository Receipt is a negotiable instrument used to tap the financial markets of various countries with a single instrument. The receipts are issued by the depository bank, in more than one country representing a fixed number of shares in a foreign company. The holders of GDR can convert them into shares by surrendering the receipts to the bank.

**Comparison Chart**

<table>
<thead>
<tr>
<th>BASIS FOR COMPARISON</th>
<th>ADR</th>
<th>GDR</th>
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<tr>
<td>Acronym</td>
<td>American Depository Receipt</td>
<td>Global Depository Receipt</td>
</tr>
<tr>
<td>Meaning</td>
<td>ADR is a negotiable instrument issued by a US bank, representing non-US company stock, trading in the US stock exchange.</td>
<td>GDR is a negotiable instrument issued by the international depository bank, representing foreign company’s stock trading globally.</td>
</tr>
<tr>
<td>Relevance</td>
<td>Foreign companies can trade in US stock market.</td>
<td>Foreign companies can trade in any country's stock market other than the US stock market.</td>
</tr>
<tr>
<td>Issued in</td>
<td>United States domestic capital market.</td>
<td>European capital market.</td>
</tr>
<tr>
<td>Listed in</td>
<td>American Stock Exchange such as NYSE or NASDAQ</td>
<td>Non-US Stock Exchange such as London Stock Exchange or Luxemborg Stock Exchange.</td>
</tr>
<tr>
<td>Negotiation</td>
<td>In America only.</td>
<td>All over the world.</td>
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<td>Disclosure Requirement</td>
<td>Onerous</td>
<td>Less onerous</td>
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<td>Market</td>
<td>Retail investor market</td>
<td>Institutional market.</td>
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</tbody>
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**Participatory Notes**

**Participatory notes also called P-Notes** are offshore derivative instruments with Indian shares as underlying assets. These instruments are used for making investments in the stock markets. However, they are not used within the country. They are used outside India for making investments in shares listed in the Indian stock market. That is why they are also called offshore derivative instruments.

**Participatory notes are issued by brokers and FIIs registered with SEBI.** The investment is made on behalf of these foreign investors by the already registered brokers in India. For example, Indian-based brokerages buy India-based securities and then issue participatory notes to foreign investors. Any dividends or capital gains collected from the underlying securities go back to the investors.

**Why are participatory notes used?**

**Investing through P-Notes is very simple and hence very popular amongst FIIs. Overseas investors who are not registered with SEBI** have to go through a lot of scrutiny, such as know-your-customer norms, before investing in Indian shares. To avoid these hurdles, foreign investors take this route. Also, since the end beneficiary of these notes is not disclosed, many investors who want to remain anonymous use it. These instruments aid investors who do not want to register with SEBI and reveal their identities to take positions in the Indian market.

**Advantages of participatory notes**

**Anonymity:** Any entity investing in participatory notes is not required to register with SEBI, whereas all FIIs have to compulsorily get registered. It enables large hedge funds to carry out their operations without disclosing their identity.

**Ease of trading:** Trading through participatory notes is easy because they are like contract notes transferable by endorsement and delivery.
Tax saving: Some of the entities route their investment through participatory notes to take advantage of the tax laws of certain preferred countries.

Disadvantages of P-notes

Indian regulators are not very happy about participatory notes because they have no way to know who owns the underlying securities. It is alleged that a lot of unaccounted money made its way to the country through the participatory note route.

Unit 4 - Role of Money Markets, Debt Markets & Forex Market

Financial markets

- Financial markets in every economy have two separate segments.
- Short-term funds are for a period of 364 days (Money market).
- Long term funds are for above 364 days (Capital Market).

Note: Chakravarthy committee (1985) for first time underlined the need of an organised money market and Vahul Committee (1987) laid the blueprint for that.

Call Money Market

The money market is a market for short-term financial assets that are close substitutes of money. The most important feature of a money market instrument is that it is liquid and can be turned into money quickly at low cost and provides an avenue for equilibrating the short-term surplus funds of lenders and the requirements of borrowers.

- The loans are of short-term duration varying from 1 to 14 days, are traded in call money market
- The money that is lent for one day in this market is known as "Call Money"
- It exceeds one day (but less than 15 days) it is referred to as "Notice Money"
- Term Money refers to Money lent for 15 days or more in the Inter Bank Market.

Participants in the Market

Participants in the call money market are banks and related entities specified by the RBI. Scheduled commercial banks (excluding RRBs), co-operative banks (other than Land
Development Banks) and Primary Dealers (PDs), are permitted to participate in call/notice money market both as borrowers and lenders. As per the new regulations, Payment Banks are also allowed to participate in CMM as both lenders and borrowers.

**Functioning of the Call Money Market**

Loans are availed through auction/negotiation. The auction is made on interest rate. Highest bidder (who is ready to give higher interest rate) can avail the loan. Average interest rate in the call market is called call rate. Dealing in call money is done through the electronic trading platform called Negotiated Trading System (NDS). This call money rate is an important variable for the RBI to assess the liquidity situation in the economy. The CMM is known as the most sensitive segment of the financial system.

**Borrowing Limits**

Scheduled commercial banks are permitted to borrow to the extent of 125% of their capital funds in the call/notice money market, however their fortnightly average borrowing outstanding should not exceed more than 100% of their capital funds (Tier I and Tier II capital). At the same time SCBs can lend to the extent of 50% of their capital funds on any day, during a fortnight, but average fortnightly outstanding lending should not exceed 25% of their capital funds. Co-operative Banks are permitted to borrow up to 2% of their aggregate deposits as at the end of March of the previous financial year in the Call/ Notice money market.

There is no limit for lending. Primary Dealers can borrow on an average in a reporting fortnight up to 225% of the total Net Owned funds (NOF) as at the end, March of the previous financial year and lend on an average in a reporting fortnight up to 25% of their NOF.

**Money Market Instruments**

**Instruments of Money Market**

- Treasury Bills
- Commercial Paper
- Commercial Bill
- Call Money
- Certificate of Deposits
- Cash Management Bills (CMBs)

**Treasury Bills**

- Issued by RBI on behalf of govt.
- Govt uses them to meet their short-term liquidity crunch.
- T-bills are sovereign zero risk instruments.
- At present, 3 types of T-bills are there: **91-day, 182-day, 364-day**.
- State govt. cannot issue T-bills.
They are issued by Market Stabilization Scheme (MSS).
Available for a minimum amount of Rs. 25000 or in multiples of that.

Call Money

- Interbank market where funds are borrowed and lent for 1 day or less.
- The money that is lent for one day in this market is known as "Call Money", and if it exceeds one day (but less than 15 days) it is referred to as "Notice Money".
- Duration varying from 1 to 14 days, it is called Call money Market.
- Mutual funds, scheduled commercial & cooperative banks act as both borrowers and lenders.
- LIC, GIC, NABARD, IDBI act only as lenders.

Certificate of Deposit (CDs)

- Issued by scheduled commercial banks and other financial institutions.
- RRBs and local area banks can not issue CDs.
- Issued at a discount to face value, the discount rate is negotiated between issuer and investor.
- Minimum amount to be Rs. 1 lac.
- CDs issued by banks have a maturity period: 15 days to 1 year.
- CDs issued by selected FIs have maturity period: 1 year to 3 years.
- Can be issued to individuals or firms.

Commercial Paper (CP)

- These are unsecured promissory* notes issued by large corporates, primary dealers, satellite dealers and all India FIs.
- Maturity period is between 7 days up to 1 year from date of issue.
- Minimum amount to be invested is Rs. 5 lacs or multiples of that.
- CPs need to have a credit rating from a credit rating agency.

Commercial Bills (CBs)

- Negotiable instruments which are issued by all India FIs, NBFCs, SCBs, Merchant banks & Mutual funds.
- Drawn by seller on the buyer (buyer gives seller), hence also called trade bills.

Cash Management Bills (CMBs)

- It's a comparatively new short-term instrument issued by RBI on behalf of Govt.
- Issued to meet temporary mismatches in cash flow of Govt.
- They resemble T-bills in character but are issued for less than 91 days only.
Debt Capital Market

The Indian debt market is a market meant for trading (i.e. buying or selling) fixed income instruments. Fixed income instruments could be securities issued by Central and State Governments, Municipal Corporations, Govt. Bodies or by private entities like financial institutions, banks, corporates, etc. Simply put, a bond/debt can be defined as a loan in which an investor is the lender. The issuer of the bond pays the investor interest (at a predetermined rate and schedule) in return for the amount invested. The Indian debt market offers a variety of debt instruments, offered by the Government and non-Government entities. The factors that are propelling the growth of the market are:

- Introduction of new instruments
- Increased liquidity
- Deregulation of interest rates
- Improved settlement systems

The debt market in India comprises broadly two segments, viz.,

- Government Securities Market and
- Corporate Debt Market.

The latter is further classified as Market for:

- PSU Bonds and
- Private Sector Bonds.

The corporate bond market, broadly comprises of corporate sector raising debt through public issuance in capital market and also through private placement basis.

FOREX (Foreign Exchange Market)

The foreign exchange market is a global online network where traders buy and sell currencies. It has no physical location and operates 24 hours a day.

Interbank Market

The interbank market is a network of banks that trade currencies with each other. Each has a currency trading desk called a dealing desk. They are in contact with each other continuously. That process makes sure exchange rates are uniform around the world.
The minimum trade is 1 million of the currency being traded. Most trades are much larger, between 10 million and 100 million in value. As a result, exchange rates are dictated by the interbank market.

**LIBOR**

LIBOR, which is an acronym of London Interbank Offer Rate, refers to the interest rate that UK banks charge other financial institutions for short-term loans. The loan maturities vary from one day to one year. LIBOR acts as a benchmarking base for short-term interest rates for prices of securities such as currency swaps, interest rate swaps, or mortgages.

LIBOR comprises seven maturities, quoted for deposits of each of five major currencies – CHF (Swiss Franc), EUR (Euro), GBP (Pound Sterling), JPY (Japanese Yen), and USD (US Dollar).

**MIBOR**

MIBOR is the acronym for Mumbai Interbank Offer Rate, the yardstick of the Indian call money market. It is used as a reference rate for floating rate notes, corporate debentures, term deposits, interest rate swaps and forward rate agreements. The pricing of overnight indexed swaps, a type of overnight interest rate swap used for hedging interest rate risk is based on overnight MIBOR.

Based on the recommendation of the Committee for the Development of Debt Market, the National Stock Exchange (NSE) launched the Mumbai Interbank Offer Rate (MIBOR) and Mumbai Interbank Bid Rate (MIBID) in June, 1998. Subsequently, the NSE developed a benchmark rate for the term money market, like the 14-day, 1-month and 3-month MIBOR.

**Foreign Exchange Management Act (FEMA)**

The Foreign Exchange Management Act (FEMA) was an official Act that consolidated and amended laws governing foreign exchange in India. The primary objective of FEMA act was “facilitating external trade and payments and promoting the orderly development and maintenance of foreign exchange market in India”. FEMA was enacted by the Parliament of India in the winter session of 1999 to replace the Foreign Exchange Regulation Act (FERA) of 1973.

**Important FEMA Guidelines and Features**

Most significantly, FEMA regarded all forex-related offences as civil offences, whereas FERA regarded them as criminal offences. Additionally, there were other important guidelines such as:

- FEMA did not apply to Indian citizens who resided outside India. This criterion was checked by calculating the number of days a person resided in India during the
previous financial year **(182 days or more to be a resident)**. It was noted that even an office, a branch, or an agency could be a ‘person’ for the purpose of checking residency.

- FEMA authorized the central government to impose restrictions on and supervise three things – payments made to any person outside India or receipts from them, forex, and foreign security deals.
- It specified the areas around acquisition/holding of forex that required specific permission of the Reserve Bank of India (RBI) or the government.
- FEMA put foreign exchange transactions into two categories – capital account and current account. A capital account transaction altered the assets and liabilities outside India or inside India but of a person resident outside India. Thus, any transaction that changed overseas assets and liabilities for an Indian resident in a foreign country, or vice versa, was classified as a capital account transaction. Any other transaction fell into the current account category.

**Important Provisions of the Act**

**Section 3:** Prohibits dealings in foreign exchange except through and authorized person. This section states that on person can, without general or special permission of the RBI:

(i) Deal in or transfer any foreign exchange or foreign securities to any person not being an authorized person

(ii) Make any payment to or for the credit of any person resident outside India in any manner.

(iii) Receive otherwise through an authorized person, any payment by order or on behalf of any person resident outside India in any manner.

**Section 4:** Restrains any person resident in India from acquiring, holding, owning, possessing or transferring any foreign exchange, foreign security or any immovable property situated outside India except as specifically provided in the Act. The term “**foreign exchange**” and “**foreign security**” are defined in sections 2(n) and 2(o) respectively of the Act. The Central govt. has made **Foreign Exchange Management Rules 2000**.

**Section 6:** Deals with Capital account transactions. This section allows a person to draw or sell foreign exchange form or to an authorized person for a capital account transaction.

**Section 7:** Deals with export of goods and services. Every exporter is required to furnish to the RBI or any other authority, a declaration, etc, regarding full export value.
Section 8: Cast the responsibility on the person resident in India who have any amount of foreign exchange due or accrued in their favour to get the same realized and repatriated to India within the specific period and the manner specified by RBI.

Section 10 and 12- Deal with duties and liabilities of the authorized person.

Section 13 and 15- of the Act Deal with penalties and enforcement of the orders of Adjudicating Authority as well power to compound contraventions under the Act.

Section 36 and 37- Pertains to the establishment of Directorate of Enforcement and the power the investigate the violation of any provisions of Act, rule regulation, notification directions or order issued in exercise of the power under this Act.

**Unit 5- Role and Function of Capital Market and SEBI**

**Capital Market**

**What is Capital Market**

Capital Market, is used to mean the **market for long term investments**, that have explicit or implicit claims to capital. Long term investments refers to those investments whose lock-in period is **greater than one year**.

In the capital market, both equity and debt instruments, such as equity shares, preference shares, debentures, zero-coupon bonds, secured premium notes and the like are bought and sold, as well as it covers all forms of lending and borrowing.

**Functions of Capital Market**

- Mobilization of savings to finance long term investments.
- Facilitates trading of securities.
- Minimization of transaction and information cost.
- Encourage wide range of ownership of productive assets.
- Quick valuation of financial instruments like shares and debentures.
- Facilitates transaction settlement, as per the definite time schedules.
- Offering insurance against market or price risk, through derivative trading.
- Improvement in the effectiveness of capital allocation, with the help of competitive price mechanism.
Types of Capital Market

- Primary Market
- Secondary Market

**Primary Market:** Otherwise called as **New Issues Market**, it is the market for the trading of new securities, for the first time. It embraces both **initial public offering and further public offering.** In the primary market, the mobilisation of funds takes place through prospectus, right issue and private placement of securities.

**Origination/ Initial Public Offerings:** In a public offering, the issuer makes an offer for the new investor to enter is shareholding family. Origination is referred to as examine, evaluate, and process new project proposals in the primary market. It begins prior to an issue is present in the market. It is done with the help of commercial bankers.

**Further Public offering (FPO):** An FPO is made when an already listed company makes either a fresh issue of securities to the public or an offer for sale to the public, through an offer document. An offer for sale in such a scenario is allowed.

**Distribution:** For the success of issue, brokers and dealers are given job distribution who directly contact with investors.

**Right Issue (IR):** Right Issue is when listed company propose to issue fresh securities to its existing shareholders as on a recorded data.

**Secondary Market:** **Secondary Market can be described as the market for old securities,** in the sense that securities which are previously issued in the primary market are traded here. The trading takes place between investors, that follows the original issue in the primary market. It covers both stock exchange and over-the-counter market.

**The following are the main financial products/instruments dealt in the secondary Market:**

**Equity:** Equity is ownership of assets that may have debts or other liabilities attached to them. Equity is measured for accounting purposes by subtracting liabilities from the value of an asset.

Equity = Assets – Liabilities

**Various type of Equity:**

- Equity share
- Right Issue/Right Share
- Bonus share
- Preferred stock/Preference share
• Cumulative Preference share
• Cumulative Convertible preference share
• Participating Preference share

**Government securities:** Popularly known as G-Secs, are **issued by Reserve Bank of India (RBI)** on **behalf of the central or state governments.** These securities are absolutely **risk-free and guaranteed by the government.** Generally, investors think that G-Secs are meant for banks, financial institutions and large corporations, but as small investors, every individual can also make an investment.

**Debentures:** Debenture is a medium- to long-term (Half yearly) debt instrument used by large companies to borrow money, at a fixed rate of interest.

**Bond:** A bond is a negotiable certificate evidencing indebtedness. It is normally **unsecured.** A Bond (debt security) security is generally **issued by a company, municipality or a government agency.**

**Coupon Bond:** These are normal bonds on which the issuer pays the investor/holder interest at the predetermined rate (Known as coupon) at agreed intervals. Normally **twice a year.** The maturity if the bond is known by the period for which it is issued.

**Zero Coupon Bond:** A bond issued at a discount and repaid at a face value is called a Zero Coupon Bond.

**Convertible Bond:** A bond giving the investor the option to convert the bond into equity at a fixed conversion price is referred to as a Convertible Bond.

**Applications Supported by Blocked Amount (ASBA)**

**What is ASBA?**

ASBA [Applications Supported by Blocked Amount] is a system of blocking the funds of applicants of IPOs in their respective accounts and release the funds to the Company from such blocked accounts only after the allotment to the extent of allotment made and unblock the remaining amount in the account.

**Features of ASBA**

• ASBA IPO Applications will be received at the Designated Branches
• On receipt of ASBA applications, the Branches will mark lien in the specific account of the customer to the extent of amount applied for through the system.
• This amount gets blocked in the account and money will however continue to remain in the account of the customer till the date of allotment.
• The details of the IPO application and the amount blocked would be passed to the Exchange and Registrar through the system.
• The amount held in the account of the customer would continue to earn interest as applicable to the account.
• Any withdrawals or debits to the extent of blocked amount are not permitted in the account till the finalisation of allotment of shares. However, balance in the account over and above the blocked amount is free from any charge.
• When the Registrar completes the process of allotment, based on the instructions released from the Registrars, the system will debit the account to extent of the allotment and will unblock the account.

**Advantages of ASBA**

• No issue of Cheque / Purchase of DDs and hence no clearing
• Applicant can make 5 applications from a single deposit account
• Money lies in the a/c and earns interest
• Lien marked only to the extent of the bid amount
• Money to be appropriated on allotment to the extent of shares allotted
• No physical refund involved, no hassles of lost / delayed refunds
• Shorter turnaround time for entire IPO processing.

**Qualified Institutional Placement**

A Qualified Institutional Placement is a capital raising tool wherein a listed company can issue equity shares, fully and partly convertible debentures, or any security other than warrants that are convertible into equity shares. But unlike in an IPO or an FPO, only institutions or qualified institutional buyers can participate in a QIP.

**Restrictions on Allotment**

Certain restrictions have been imposed wherein it is mentioned that in any whatsoever, the Qualified Institutional Placement cannot be made to the Promoter or any of his relatives or to any manner who may be related to the promoter in any way. Also a Minimum number of of QIBs to whom shares are allotted shall not be less than Two, in cases where the issue size is <= Rs.250 crores.
Advantages of a QIP

- This mode of qualified institutional placement is essentially the most expeditious method by which capital can be raised without undergoing any cumbersome process. Generally, by other methods like FPO and rights issues, it takes a lot of time and money to undergo the documentation and approval.
- It saves ancillary expenses which otherwise are involved when securities are issued by some any other mode.
- In cases where a company cannot directly buy from the market a large stake as it might create market volatility, in this way issuing shares by increasing capital is one of the ways to attract investors.
- Better bargains take place by means of QIP, as it gives the opportunity to raise and purchase as well at better-bargained costs.
- Finally, in case of QIP the formula to arrive at a floor price, is the average stock price of the last two weeks, but in case of preferential allotment, it is the average stock price of last six months from the cut-off date. The cut-off date for calculation of average stock price is the date which is 30 days prior to the date when shareholders’ meeting is held and the decision of fresh equity issue is taken.

SEBI – Securities and Exchange Board of India

What is SEBI?

SEBI is a statutory regulatory body established on the 12th of April, 1992 SEBI Act 1992. It monitors and regulates the Indian capital and securities market while ensuring to protect the interests of the investors formulating regulations and guidelines to be adhered to. The head office of SEBI is in Bandra Kurla Complex, Mumbai.

Functions of SEBI

- SEBI is primarily set up to protect the interests of investors in the securities market.
- It promotes the development of the securities market and regulates the business.
- SEBI provides a platform for stockbrokers, sub-brokers, portfolio managers, investment advisers, share transfer agents, bankers, merchant bankers, trustees of
trust deeds, registrars, underwriters, and other associated people to register and regulate work.

- It regulates the operations of depositories, participants, custodians of securities, foreign portfolio investors, and credit rating agencies.
- It prohibits inner trades in securities, i.e. fraudulent and unfair trade practices related to the securities market.
- It ensures that investors are educated on the intermediaries of securities markets.
- It monitors substantial acquisitions of shares and take-over of companies.
- SEBI takes care of research and development to ensure the securities market is efficient at all times.

**Authority and Power of SEBI**

Power of SEBI to Regulate or Prohibit Issue of Prospectus, offer Document or Advertisement Soliciting Money for issue of Securities: Without prejudice to the provisions of the Companies Act, 1956 (1 of 1956), SEBI may, for the protection of investors.

Quasi-Judicial: SEBI has the authority to deliver judgements related to fraud and other unethical practices in terms of the securities market. This helps to ensure fairness, transparency, and accountability in the securities market.

Quasi-Executive: SEBI is empowered to implement the regulations and judgements made and to take legal action against the violators. It is also authorised to inspect Books of accounts and other documents if it comes across any violation of the regulations.

Quasi-Legislative: SEBI reserves the right to frame rules and regulations to protect the interests of the investors. Some of its regulations consist of insider trading regulations, listing obligation, and disclosure requirements. These have been formulated to keep malpractices at bay.

Despite the powers, the results of SEBI’s functions still have to go through the Securities Appellate Tribunal and the Supreme Court of India.

**Registration of stock brokers, sub-brokers, share transfer agents, etc.**

- No stock broker, sub-broker, share transfer agent, banker to an issue, trustee of trust deed, registrar to an issue, merchant banker, underwriter, portfolio manager, investment adviser and such other intermediary who may be associated with
securities *market shall buy, sell or deal in securities except under*, and in accordance with, the conditions of a certificate of registration obtained from the Board in accordance with the regulations made under this Act:

- Provided further that any certificate of registration, obtained immediately before the commencement of the *Securities Laws (Amendment) Act, 1995*, shall be deemed to have been obtained from the Board in accordance with the regulations providing for such registration.

- Provided that a person buying or selling securities or otherwise dealing with the securities market as a depository, participant, custodian of securities, foreign institutional investor or credit rating agency immediately before the commencement of the *Securities Laws (Amendment) Act, 1995*, for which no certificate of registration was required prior to such commencement, may continue to buy or sell securities or otherwise deal with the securities market until such time regulations are *made under clause (d) of sub-section (2) of section 30*.

- Provided that any person sponsoring or causing to be sponsored, carrying or causing to be carried on any venture capital funds or collective investment schemes operating in the securities market immediately before the *commencement of the Securities Laws (Amendment) Act, 1995*, for which no certificate of registration was required prior to such commencement, may continue to operate till such *time regulations are made under clause (d) of sub-section (2) of section 30*.  

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**Unit 6: Role and Functions of Mutual Funds, Insurance Companies, Bancassurance and Insurance Regulatory and Development Authority (Irda)**

### Mutual Funds

**What is a Mutual Fund?**

Mutual fund is a mechanism for pooling resources from the public by issuing units to them and investing the funds, so collected in securities in accordance with objectives as disclosed in an offer document.

**Management of Mutual Funds**
• Mutual fund is set up in the form of trust, which is established by a sponsor or more than one sponsor.
• It is managed by Asset Management Company
• SEBI regulations require that:
  • At least two-thirds of the directors of trustee company or board of trustees must be independent.
  • 50% of the directors of the AMC must be independent
  • SEBI approved custodian holds the securities.
• Performance of a particular scheme of MF is denoted by Net Asset Value (NAV)

Different Types of Mutual Fund Schemes
• Open-ended scheme – Subscription and repurchase in these schemes are available on a continuous basis. These schemes do not have fixed maturity periods. The key feature is liquidity.
• Close-ended scheme - The fund is open for subscription only for a specific period. It has fixed maturity period. Units are listed on stock exchange where new investors can enter and old investors can exit.
• Growth scheme/Equity Oriented scheme - The aim of these funds is to provide capital appreciation over medium to long term period. Major portion of investment is made in equities. Carries high risk.
• Income scheme/Debt Oriented scheme - The aim of these funds is to provide regular income. Investment is made in fixed income securities such as bonds, corporate debentures, government securities and money market instruments. Less risky schemes.
• Balanced Scheme - The aim is growth and regular income. Investment is made both in equity and fixed return securities in the ratio (40:60).
• Liquid Fund - These are income funds. It provide easy liquidity. It preserves capital and ensure moderate income. Return in these funds are lower.
• Gilt Fund - Invests in Government securities. These have no default risk. NAVs fluctuates due to change in interest rates and other economic factors.
• Index Fund - It replicate the portfolio of a particular index (SENSEX, NIFTY). NAV would rise or fall in accordance with the rise or fall in the index.
• Sector Specific Fund - It invests in securities of only those sectors as specified in the offer document (Pharma, Software, FMCG etc). Return is dependent on the performance of that specific sector. Very risky.
• Tax saving scheme - It offers tax rebate to the investors under specific provisions. ELSS and pension schemes launched by the MF offer tax benefits.
• Fund of funds - Invests in other schemes of same or other mutual fund. Spreads risks across a greater universe.

Calculation of Net Asset Value (NAV)
NAV per unit is the market value of the securities of a scheme after making adjustment for the expenses incurred on the scheme.
NAV = Market value of scheme’s investment + Current assets – current liabilities and provision

No. of units o/s under scheme on the valuation date

Example: A mutual fund company has Rs. 150 crore of investments, based on closing prices for each individual asset. It also has Rs. 5 crore of cash equivalent on hand and Rs. 2 crore in total receivables. Accrued income for the day is Rs. 50000. Fund has Rs. 10 crore in short term liabilities and Rs. 2 crore in long term liabilities. Accrued expenses for the day are Rs. 20,000. Outstanding shares are 10 crore. Calculate the NAV.

NAV = Rs 150cr + Rs. 5 crore + Rs. 2 crore + Rs. 50000 – (10 crore+ 2 crore+ 10000) 

= 11570050000 – 120010000

= 100000000

= Rs. 14.50

Rajiv Gandhi Equity Savings Scheme

- RGESS is a new equity tax advantage savings scheme with the objective of encouraging the savings of small investors in the domestic capital markets.
- Investment made in RGESS are eligible for deduction under section 80CCG.
- It gives tax benefits to new investors who invests upto Rs. 50,000 and whose gross total annual income is less than or equal to Rs. 12 lakh.

New Fund Offer (NFO) Period

- In case of open ended and close ended schemes (except ELSS schemes), the NFO should be open for upto 15 days.
- The NFO period in case of ELSS to be governed by guidelines issued by Government of India.
- The maximum period of initial offering of mutual fund scheme eligible under RGESS shall be thirty days.
- AMCs shall make investment out of NFO proceeds only on or after the closure of NFO period
- The mutual fund should allot units/refund of money and dispatch statements of accounts within five business days from the closure of the NFO.
- All the schemes (Except ELSS, RGESS) shall be available for ongoing repurchase/sale/trading within five business days of allotment.

Product labeling in Mutual Funds

1. Nature of scheme : Short/medium/long term
2. Investment objective : Equity /Debt2
3. Level of risk: It is depicted by colour
   - Blue – Principal at low risk
• Yellow - Principal at medium risk
• Brown - Principal at high risk

**Systematic Investment Plan**
An SIP is not a scheme but rather a feature that is available in most schemes, which allows a person to invest a fixed sum either monthly or quarterly, for a predetermined period as may be decided.

**Benefits of SIP**-
- Promote a disciplined approach because a person is committed to invest a fixed amount on a regular basis.
- Ensure that a person is not swayed by any market sentiment
- Free to choose any amount and in most schemes one can withdraw at his/her convenience

**Insurance Companies**
- The First insurance company in India was started in 1818 in Kolkata.
- An ordinance was issued on **19th January 1956 nationalizing the life insurance sector** and Life Insurance Corporation of India came into existence in the same year.
- LIC absorbed 154 Indian, 16 non-indian and also 75 provident societies.

*Insurance* - Insurance can be defined as a contract between two parties, where on promises the other to indemnify or make good any financial loss suffered by the latter (the insured) in consideration for an amount received by way of ‘premium’.

**Players in the Indian Insurance Market**-
- Till the year 1999-2000, LIC was the sole player and in general insurance, GIC with its 4 subsidiary was the major player.
- The insurance sector was opened up in the year 1999.
- Presently – 24 companies in life insurance and 33 companies in general insurance are working, in addition to 2 re-insurer.

**Fundamental principles of Insurance Contract**

**Principle of Utmost Good Faith**:
- It is duty of insured, to disclose all facts material to the risk being proposed to be covered, whether requested or not.
- Age, health, family details etc in case of life insurance.
- Model, seating capacity, year of make etc, (in case of general insurance)
- Non-disclosure, even unintentional can render insurance contract voidable at option of insurer.

**Principle of Insurable Interest**:
• Insurable interest means the right to insure. Policy holder must have pecuniary (financial) interest in insurance.
• Insurable interest is said to exist, if any damage to property (or person) should result in financial loss to insured.
• In life policy, such interest exist in relationship based on emotion.
• No insurance contract can exist, without insurable interest.

**Principle of Indemnity:**
• General Insurance contract is a contract of indemnity (ie. to make good the loss)
• Life insurance is not a contract of indemnity as loss cannot be made good
• Loss to be compensated is calculated on the basis value of asset and amount of insurance.
• Stock worth Rs. 15 lac. Insurance Rs. 12 lac. Loss to stock Rs. 8 lac
• Claim liability of insurance company = 8*12/15 = 6.40 lac

**Principle of Subrogation:**
• Rights of insured (say to sue 3rd parties for loss) are transferred to insurer on payment of claim.
• X is insured for personal accident. He is hit by a car. The driver of the car was drunk. X can claim from insurance company. Insurance company can claim from car owner/driver.

**Principle of Contribution:**
• If a person is insured by more than one insurer, max amount if claim is restricted to amount of loss.
• It is shared by all insurers. If one of them makes payment, it can recover from other insurers

**Principle of Proximate Cause:**
• It means immediate cause of mishap, that resulted into loss.
• If cause is different from the one, for which insurance is obtained, the insurer is not liable. **Example:** Fire insurance taken for short circuiting. Fire caused by leakage of LPG cylinder. Insurance company not liable.

**Types of Insurance Business**
• Life
• Health
• Travel
• Motor
• Property

**Term insurance plans:**
• Furnishes protection for a limited number of years (10 or 20 years upto age of 65 or 70 years)
• Nothing is paid in case of survival
• Face value is paid on death of the insured, before maturity
• Suitable for low income person or who started business or who are threshold of their career.

**Whole Life Policy:**
• Provides cover for over one's entire life.
• Face value is payable on death of the insured
• Gross premium remains same throughout the premium payment period.

**Endowment Policy:**
• Face value payable on death of insured before maturity.
• On maturity face value is payable to the insured.
• Policies are issued with a specific term of (say) 10-15-20-25-30 years
• For shorter duration, premium is higher.

**With profit policy:**
• Policy holder entitled to profit or surplus to the insurer
• Surplus is paid as bonus. It is based on valuation of assets and liabilities.

**Without profit:**
• No entitlement for profit. But premium is low compared to ‘with profit’

**Money back policy:**
• Insured received a certain percentage of sum assured periodically as survival benefit.
• On maturity balance amount is paid. Life risk is covered for the full amount.

**Unit Linked Insurance Policy:**
• It offers a combination of insurance and investment.
• In case of death, the sum insured is paid to the family.

**Annuity or Pension Plans:**

There are 2 types of plans

**Immediate annuity** : Annuity payment from insurance company begins immediately after payment of premium in lump sum.

**Deferred annuity:**
• A person contributes regularly till vesting age / vesting date.
• Single payment can also made
• Fund accumulates and is available on vesting date
• 1/3rd can be encashed on vesting date and 2/3rd utilised to purchase the annuity.

**Calculation of paid up value of a policy**
When premium is paid for a certain minimum period and not for the entire period, the sum insured is reduced proportionately.

**It is calculated as:**
- **Paid up value** = No. of premium paid / no. of premium payable * sum insured.
- Example: Sum assured is 10 lac. No of premium payable is 10. Policyholder paid only 5. Bonus accrued till 5th premium is Rs. 1.5 lac. What is paid up value.

**Solution:**
\[
\text{Paid up value} = \frac{5}{10} \times 10 \text{ lac} = 5 \text{ lac} + \text{Bonus (1.5 lac)} = 6.5 \text{ lac}
\]

**Health Insurance**
- It covers medical expenses.
- It is similar to other general insurance policies.
- The expenses include: room, boarding, nursing expenses etc.
- Sum insured offered may be on an individual basis or on floater basis for the family.
- It provides tax benefit under section u/s 80 Income Tax Act.

**Travel Insurance**
- It provides insurance protection while on travel (domestic or overseas).
- It covers travel related accident, unexpected medical expenses during travel time, loss of baggage/passport, delay in flights etc.

**Motor Insurance**

**Motor insurance provides cover for**
- damage to vehicle and
- liability payable to 3rd parties by the owner
- Under Motor Vehicles Act 1988, driving without insurance in a public place, is punishable.

**Types of policies:**
1. Liability only policy which is a statutory requirement.
2. Package policy (liability only + damage to vehicle)

- Damage covered by OD cover include fire, explosion, riot, burglary, flood, cyclone, earthquake, malicious act etc.
- Damage not covered include not having valid driving license, driving under influence of liquor, accident beyond geographical limit etc.
- 3rd party liability insurance is mandatory, which covers injuries and damages.
- Certificate of insurance is issued in Form 51 under rule 141 of Central Motor Vehicle Rules 1989.

**Property Insurance Policy:**
- It covers building, machinery, stock etc against fire, burglary etc.
- Goods in transit (rail, road, sea, air) are covered by Marine Cargo Insurance.
• Property insurance is a very wide category of general insurance.
• Packages or Umbrella covers are available (Householder policy, shopkeeper policy, office package policy etc.

Fire Insurance Policy:
• It provides protection against loss or damage to different type of property due to fire.
• In addition to fire, it provides cover against explosion, riot, strike, malicious damage, lightening etc
• It does not cover loss or damage caused by war, nuclear perils, pollution.
• The policy is issued for one year but it can be long term policy also for dwelling.

Salvage: When insurance claim is settled on total loss basis, partly damaged goods or cars or machinery, becomes property of insurance company called salvage. Its realized value is set off against losses to insurance company.

Group Insurance
• It is a plan of insurance which provides life cover to a number of persons under a single policy called the ‘Master Policy’. One important feature is with regard to selection and underwriting of lives, Individual lives are not assessed. The selection is of the group. Group selection is aimed at forming a group, which will show an average rate of mortality.

Social Security Scheme – AAM AADMI BIMA YOJANA(AABY)
• Government has merged the to social sector life insurance schemes viz. Janashree Bima Yojana (JBY) and the Aam Aadmi Bima Yojana (AABY) into the AAM AADMI BIMA YOJANA(AABY)
• The scheme extends life and disability cover to persons between the age of 18 years to 59 years, living below and marginally above the poverty line.
• The member should be the head of the family or one earning member of the family under the eligible groups.
• The scheme provides for insurance cover for a sum of Rs. 30,000/- on natural death, 75000 on death due to accident, Rs. 37,500/- for partial permanent disability due to accident.
• The total annual premium under the scheme is Rs. 200 per beneficiary, 50% of which is contributed from the social security fund created by the Central Govt and maintained by LIC. The balance 50% of the premium is contributed by the State Government.

BANCASSURANCE
• Bancassurance is defined as selling of insurance products through banks.
• Insurance is a permissible form of business that could be undertaken by banks under section 6 (1)(o) of the Banking Regulations Act, 1949.
Convergence of Banking and Insurance: The advantages of banks are many like improved customer retention, overall customer satisfaction, provision of a very good avenue for earning risk free non-interest income by means of commission over a long period etc.

**Bancassurance Models:**
Internationally, four models are used-
- Corporate agency model or distribution alliance model (used in India)
- Joint venture model, where an insurance company and a bank share the equity capital of their joint venture, subject to local government regulations. (used in India)
- Merger between a bank and an insurer (not used in India)
- Build or buy own insurance operation (not used in India)

**Insurance Regulatory and Development Authority of India (IRDA)**

IRDA was constituted on 19th April 2000. It is an autonomous body to regulate and develop the business of insurance and reinsurance in the country in terms of IRDA Act, 1999. The key objective is to promote market efficiency and ensure consumer protection.

**Duties, Powers and Functions of IRDA**
- Protection of interest of policyholders
- Licensing of insurance companies
- Making rules for all insurance intermediaries.

**Insurance Ombudsman**
- The insurance ombudsman is empowered to redress customer grievances in life insurance for an amount not exceeding Rs. 20 lakh.
- Complaint can be made to IO if – the concerned insurance co. and the insurer either should have rejected the complaint or no reply is received by the complainant within a period of 1 month from the date of receipt of complaint or the complaint is not made later than 1 year after the insurer had replied or the same complaint should not be pending in court, consumer forum or before an arbitrator.

**Unit 7- Factoring, Forfaiting Services and Off-Balance Sheet items**
Factoring

Factoring implies a financial arrangement between the factor and client, in which the firm (client) gets advances in return for receivables, from a financial institution (factor). It is a financing technique, in which there is an outright selling of trade debts by a firm to a third party, i.e. factor, at discounted prices.

Process of Factoring

In finer terms factoring is a relationship between the factor and the client, in which the factor purchases the client’s account receivables and pay up to 80% (sometimes 90%) of the sum immediately, at the time of entering into the agreement. The factor pays the balance sum, i.e. 20% of the amount which includes finance cost and operating cost, to the client when the customer pays the obligation.

- Borrowing company or the client sells the book debts to the lending institution (factor).
- Factor acquires the receivables and extend money against the receivables, after deducting and retaining the following sum, i.e. an adequate margin, factor’s commission and interest on advance
- Collection from the customer is forwarded by the client to the factor and in this way, the advance is settled.

Other services are also provided by the factor which includes:

- Finance
- Collection of debts
- Maintenance of debts
- Protection of Credit Risk
- Maintenance of debtors ledger
- Debtors follow-up
- Advisory services
- The factor gets control over the client’s debtors, to whom the goods are sold on credit or credit is extended and also monitors the client’s sales ledger.
Types of Factoring

Recourse and Non-recourse Factoring: In this type of arrangement, the financial institution, can resort to the firm, when the debts are not recoverable. So, the credit risk associated with the trade debts are not assumed by the factor.

On the other hand, in non-recourse factoring, the factor cannot recourse to the firm, in case the debt turn out to be irrecoverable.

Disclosed and Undisclosed Factoring: The factoring in which the factor’s name is indicated in the invoice by the supplier of the goods or services asking the purchaser to pay the factor, is called disclosed factoring.

Conversely, the form of factoring in which the name of the factor is not mentioned in the invoice issued by the manufacturer. In such a case, the factor maintains sales ledger of the client and the debt is realized in the name of the firm. However, the control is in the hands of the factor.

Domestic and Export Factoring: When the three parties to factoring, i.e. customer, client, and factor, reside in the same country, then this is called as domestic factoring.

Export factoring, or otherwise known as cross-border factoring is one in which there are four parties involved, i.e. exporter (client), the importer (customer), export factor and import factor. This is also termed as the two-factor system.

Advance and Maturity Factoring: In advance factoring, the factor gives an advance to the client, against the uncollected receivables.

In maturity factoring, the factoring agency does not provide any advance to the firm. Instead, the bank collects the sum from the customer and pays to the firm, either on the date on which the amount is collected from the customers or on a guaranteed payment date.
Advantages of Factoring

- Factoring replaces high cost market credit and enables purchases on cash basis for availing cash discount.
- The Customer gets instant finance against each invoice.
- Low margin (Up to 20%) thereby improvement cash flow.
- The customer gets large credit/grace period
- Each invoice is following up for payment by the factor on the due date and thereafter.
- MIS reports and sales ledger administration is totally taken care of by the factor.
- Factoring accelerates receivables turnover and improves operating cycle, resulting in more production, larger scale, higher profits and increased ROI.

Forfaiting Services

Forfaiting is a mechanism, in which an exporter surrenders his rights to receive payment against the goods delivered or services rendered to the importer, in exchange for the instant cash payment from a forfaiter. In this way, an exporter can easily turn a credit sale into cash sale, without recourse to him or his forfaiter.

Process
**Advantage of Forfaiting**

Forfaiting provide a flexible, creative alternative to traditional international trade financing methods and is particularly useful for transactions with buyers in developing nations. The following are the advantages of forfaiting to the exporters:

(i)**Forfaiting provided 100% financing**- without recourse and not occupying exporter’s credit line. This is to say once the exporter obtains the financed fund, he will be exempted from the responsibility to repay the debt.

(ii)**Forfaiting improves cash flow of the exporter**- by converting receivables into current cash inflow and it is beneficial to the exporter to improve his liquidity and his ability to improve further the fund raising capability.

(iii)**Forfaiting saves administration cost**- by using forfaiting, the exporter will be freed from the management of the receivables. The relative costs, as a result, will be reduced greatly.

(iv)**Forfaiting increase trade opportunity**- with forfaiting, the exporter is able to grant credit to his buyer freely and thus, be more competitive in the market.
## Comparison Chart

<table>
<thead>
<tr>
<th>BASIS FOR COMPARISON</th>
<th>FACTORING</th>
<th>FORFAITING</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Meaning</strong></td>
<td>Factoring is an arrangement that converts your receivables into ready cash and you don't need to wait for the payment of receivables at a future date.</td>
<td>Forfaiting implies a transaction in which the forfafter purchases claims from the exporter in return for cash payment.</td>
</tr>
<tr>
<td><strong>Maturity of receivables</strong></td>
<td>Involves account receivables of short maturities.</td>
<td>Involves account receivables of medium to long term maturities.</td>
</tr>
<tr>
<td><strong>Goods</strong></td>
<td>Trade receivables on ordinary goods.</td>
<td>Trade receivables on capital goods.</td>
</tr>
<tr>
<td><strong>Finance up to</strong></td>
<td>80-90%</td>
<td>100%</td>
</tr>
<tr>
<td><strong>Type</strong></td>
<td>Recourse or Non-recourse</td>
<td>Non-recourse</td>
</tr>
<tr>
<td><strong>Cost</strong></td>
<td>Cost of factoring borne by the seller (client).</td>
<td>Cost of forfaiting borne by the overseas buyer.</td>
</tr>
<tr>
<td><strong>Negotiable Instrument</strong></td>
<td>Does not deals in negotiable instrument.</td>
<td>Involves dealing in negotiable instrument.</td>
</tr>
<tr>
<td><strong>Secondary market</strong></td>
<td>No</td>
<td>Yes</td>
</tr>
</tbody>
</table>

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### OFF-BALANCE SHEET ITEM

Also known as **Off-Balance sheet items**, **Off-Balance sheet assets or liabilities**, and **Incognito Leverage**. They are either a liability or an asset which are not shown on a company’s/Bank balance sheet as the business is not a legal owner of the respective item.

Off-Balance sheet items are generally shown in the notes to accounts along with the financial statements. These assets and liabilities may be used by a company/Bank; however, the legal
ownership may or may not belong to them. In this case, the consumption of assets and payment of liabilities may ultimately be an indirect responsibility.

The term is very common with asset management companies, brokerage firms, wealth managers, etc. In this case, the assets being managed by firms do not belong to them but to the clients, so they are not recorded on the balance sheet.

**There are item Include:**

(a) Direct Credit substitutes, e.g. general guarantees of indebtedness (including stand by CLs serving as financial guarantees for loans and securities) and acceptance (including endorsements with the character of acceptance).

(b) Certain transaction-related contingent item (e.g performance bonds, bid bonds warranties and standby LCs related to particular transactions).

(c) Short-term self liquidating trade-related contingencies (such as documentary credits collateralized by the underlying shipment)

(d) Take-out finance in the books of taking over institution

(i) Unconditional take-out finance

(ii) Conditional take-out finance

(iii) Non-funded exposures to commercial real estate

(e) Foreign exchange open position

(f) Open position in gold

**Bank Guarantee**

A guarantee means giving something as security. A bank guarantee is when a bank offers surety and guarantees for different business obligation on behalf of their customers within certain regulations. It is generally a promise made by the bank to any third person to undertake the payment risk on behalf of its customers.

Bank guarantee is given on a contractual obligation between the bank and its customers. Such guarantees are widely used in business and personal transactions to protect the third party from financial losses.

**Advantage of Bank Guarantees**

- Bank guarantee reduces the financial risk involved in the business transaction.
- Due to low risk, it encourages the seller/beneficiaries to expand their business on a credit basis.
• Banks generally charge low fees for guarantees, which is beneficial to even small-scale business.
• When banks analyse and certify the financial stability of the business, its credibility increases and this, in turn, increase business opportunities.
• Mostly, the guarantee requires fewer documents and is processed quickly by the banks (if all the documents are submitted).

**Disadvantage of Bank Guarantees**

• Sometimes, the banks are so rigid in assessing the financial position of the business. This makes the process complicated and time-consuming.
• With the strict assessment of banks, it is very difficult to obtain a bank guarantee by loss-making entities.
• For certain guarantees involving high-value or high-risk transactions, banks will require collateral security to process the guarantee.

**Types of Guarantees**

**Financial Guarantee** – These guarantees are generally issued in lieu of security deposits. Some contracts may require a financial commitment from the buyer such as a security deposit. In such cases, instead of depositing the money, the buyer can provide the seller with a financial bank guarantee using which the seller can be compensated in case of any loss.

**Performance Guarantee** – These guarantees are issued for the performance of a contract or an obligation. In case, there is a default in the performance, non-performance or short performance of a contract, the beneficiary’s loss will be made good by the bank.

**Deferred payment guarantee**: This refers to a bank guarantee or a payment guarantee that is offered to the exporter for a deferred period or for a certain time period. When a buyer purchases capital goods or machinery, the seller will give credit to the buyer when the buyer’s bank gives a guarantee that it will pay the unsettled dues of the buyer to the seller. Under this type of guarantee, payment will be made in installments by the bank for failure in supplying raw materials, machinery or equipment.

**Letter of Credit**

A letter of credit is a document that guarantees the buyer’s payment to the sellers. It is issued by a bank and ensures the timely and full payment to the seller. If the buyer is unable to make such a payment, the bank covers the full or the remaining amount on
behalf of the buyer. **A letter of credit is issued against a pledge of securities or cash.**

Banks typically collect a fee, ie, a percentage of the size/amount of the letter of credit.

**Parties to a letter of Credit**

- Applicant (importer) requests the bank to issue the LC
- Issuing bank (importer’s bank which issues the LC [also known as the Opening banker of LC])
- Beneficiary (exporter)
- Advising Bank
- Confirming Bank

**Types of Credit**

**Sight Credit:** Under this LC, documents are payable at the sight/ upon presentation of the correct documentation.

**For example,** a businessman can present a bill of exchange to a lender along with a sight letter of credit and take the necessary funds right away. A sight letter of credit is more immediate than other forms of letters of credit.

**Acceptance Credit/ Time Credit:** The Bills of Exchange which are drawn and payable after a period, are called usance bills. Under acceptance credit, these usance bills are accepted upon presentation and eventually honoured on their respective due dates.

**Revocable and Irrevocable Credit:** A revocable LC is a credit, the terms and conditions of which can be amended/ cancelled by the Issuing Bank. This cancellation can be done without prior notice to the beneficiaries.

An irrevocable credit is a credit, the terms and conditions of which can neither be amended nor cancelled. Hence, the opening bank is bound by the commitments given in the LC.

**Confirmed Credit:** Only Irrevocable LC can be confirmed. A confirmed LC is one when a banker other than the Issuing bank, adds its own confirmation to the credit. In case of confirmed LCs, the beneficiary’s bank would submit the documents to the confirming banker.

**Back-to-Back credit:** In a back to back credit, the exporter (the beneficiary) requests his banker to issue an LC in favour of his supplier to procure raw materials, goods on the basis of the export LC received by him. This type of LC is known as Back-to-Back credit.

**Transferable Credit:** While an LC is not a negotiable instrument, the Bills of Exchange drawn under it are negotiable. A Transferable Credit is one in which a beneficiary can transfer his rights to third parties. Such LC should clearly indicate that it is a ‘Transferable’ LC.
**Differences between Letter of Credit (LOC) and Bank Guarantee (BG)**

<table>
<thead>
<tr>
<th>Particulars</th>
<th>LOC</th>
<th>BG</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Nature</strong></td>
<td>LOC is an obligation accepted by a bank to make payment to a beneficiary if certain services are performed.</td>
<td>BG is an assurance given by the bank to the beneficiary to make the specified payment in case of default by the applicant.</td>
</tr>
<tr>
<td><strong>Primary liability</strong></td>
<td>Bank retains the primary liability to make the payment and later collects the same from the customer.</td>
<td>The bank assumes to make the payment only when the customer defaults to make payment.</td>
</tr>
<tr>
<td><strong>Payment</strong></td>
<td>Bank makes the payment to the beneficiary as and when it is due. It need not wait for a default to be made by the customer.</td>
<td>Only when the customer defaults the payment to the beneficiary, the bank makes the payment.</td>
</tr>
<tr>
<td><strong>Way of working</strong></td>
<td>LOC ensures that the amount will be paid as long as the services are performed as per the agreed terms.</td>
<td>BG assures to compensate for the loss if the applicant does not satisfy the specified conditions.</td>
</tr>
<tr>
<td><strong>Number of parties involved</strong></td>
<td>There are multiple parties involved here - LOC Issuing bank, its customer, the beneficiary (third party), and advising bank.</td>
<td>There are only three parties involved - banker, its customer, and the beneficiary (third party).</td>
</tr>
<tr>
<td><strong>Suitability</strong></td>
<td>Generally, this is more appropriate during the import and export of goods and services.</td>
<td>Suits any business or personal transactions.</td>
</tr>
<tr>
<td><strong>Risk</strong></td>
<td>Bank assumes more risk than the customer.</td>
<td>Customer assumes the primary risk.</td>
</tr>
</tbody>
</table>

**Forward Rate Agreement (FRA) and Interest Rate Swap (IRS)**
Forward Rate Agreement (FRA)

- FRAs are forwards hence they are private contracts between counterparties.
- The forward rate is locked in a FRA contract.
- Buyer benefits when borrowing rate increases.
- Seller benefits when borrowing rate decreases.

Interest Rate Swap (IRS)

- Interest rate swap (IRS) is a type of swap and hence belongs to the class of derivatives. Its price is derived by market interest rates.
- An interest rate swap is a financial agreement between parties to exchange fixed or floating payments over a period of time.

Unit 8: Risk Management; Basel I, II & III Accords

Risk Management

In the course of their operations, banks are invariably faced with different types of risks that may have a potentially adverse effect on their business. Banks are obliged to establish a comprehensive and reliable risk management system, integrated in all business activities and providing for the bank risk profile to be always in line with the established risk propensity.

Risk Management Function

- Risk management strategy and policies, as well as procedures for risk identification and measurement, i.e. for risk assessment and risk management;
- Appropriate internal organisation, i.e. bank’s organizational structure;
- Effective and efficient risk management process covering all risks the bank is exposed to or may potentially be exposed to in its operations;
- Adequate internal controls system;
- Appropriate information system;
- Adequate process of internal capital adequacy assessment.
- Strong MIS for reporting, monitoring and controlling risks
• Well laid out procedures, effective control and comprehensive risk reporting framework.
• Periodical review and evaluation.

Type of Risk Management

**Liquidity risk** is the risk of potential occurrence of adverse effects on the bank’s financial result and capital due to the bank’s inability to meet the due liabilities caused by the withdrawal of the current sources of funding, that is, the inability to raise new funds (funding liquidity risk), aggravated conversion of property into liquid assets due to market disruption (market liquidity risk).

**Credit risk** is the risk of potential occurrence of adverse effects on the bank’s financial result and capital due to debtor’s default to meet its obligations to the bank.

Credit risk may take the following forms:

(a)**Direct lending**: Principal and/or interest amount may not be repaid.

(b)**Guarantees or letter of credit**: Funds may not be forthcoming from the constituents upon crystallization of the liability.

(c)**Securities trading business**: Funds/securities settlement may not be effected.

(d)**Cross-border exposure**: The availability and free transfer of foreign currency funds may either cease or restrictions may be imposed by the sovereign.

**Market risks** entail foreign exchange risk, price risk on debt securities, price risk on equity securities, and commodity risk.

**Interest rate risk** is the risk of possible occurrence of adverse effects on the bank’s financial result and capital on account of banking book items caused by changes in interest rates.

**Foreign exchange risk** is the risk of possible occurrence of adverse effects on the bank’s financial result and capital on account of changes in foreign exchange rates.

**Operational risk** is the risk of possible adverse effects on the bank’s financial result and capital caused by omissions (unintentional and intentional) in employees’ work, inadequate internal procedures and processes, inadequate management of information and other systems, as well as by unforeseeable external events. Operational risk also includes legal risk.

BASEL NORM
Basel is a city in Switzerland which is also the headquarters of Bureau of International Settlement (BIS).

The Bank for International Settlements (BIS) established on 17 May 1930, is the world's oldest international financial organisation. There are two representative offices in the Hong Kong and in Mexico City.

**BASEL- I**

- In 1988, The Basel Committee on Banking Supervision (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).**
- India adopted **Basel 1 guidelines in 1999.**
- In India, however banks are required to maintain a minimum Capital-to-risk weighted Asset ratio (CRAR) of **9% on an ongoing basis.**

**BASEL- II**

In 2004, Basel II guidelines were published by BCBS, which were considered to be the refined and reformed versions of Basel I accord.

**Three Pillars of Basel II**

(i)**First Pillar:** Minimum capital Requirement

(a)Calculation of minimum capital requirements and constituents of capital

(b)Credit Risk
- Standardized Approach
- Internal Ratings-based Approach
- Securitisation Framework

(c)Market Risk

(d)Operational Risk

(ii)**Second Pillar:** Supervisory review process

(iii)**Third Pillar:** Market Discipline.
**First Pillar: Minimum capital Requirement**

The Capital base of the bank consist of the following three types of capital element. *Tier 1, Tier 2 and Tier 3 capital*. The sum of Tier 1, Tier 2 and Tier 3 element will be eligible for inclusion in the capital base, subject to the following limits.

(a) Total of Tier 2 (Supplementary) elements will be limited to a maximum of 100% of the Tier 1 element.

(b) Subordinated term debt will be limited to a maximum of 50% of Tier 1 elements.

(c) Tier 3 capital will be limited to 250% of a bank’s Tier 1 capital that is required to support market risks.

(d) Where general provisions/general loan –loss reserves include amounts reflecting lower valuations of assets or latent but unidentified losses present in the balance sheet, the amount of such provisions or reserves will be limited to a maximum of 1.25% point.

(e) Asset revaluation reserves, which take the form of latent gains on unrealized securities, will be subject to a discount of 55%.

**Second Pillar: Supervisory review process**

The section discusses the key principles of supervisory review, risk management guidance and supervisory transparency and accountability, produced by the committee with respect to banking risks. This includes guidance relating to, among other things, the treatment of interest rate risk in the banking book, credit risk, operational risk etc.

**Four key of Principles of Supervisory Review:**

The Committee has identified four key principles of supervisory review, which complement those outlined in the extensive supervisory guidance that has been developed by the committee.

**Principle 1:** Banks should have a process for assessing their overall capital adequacy in relation to their risk profile and a strategy for maintaining their capital levels.

**Principle 2:** Supervisors should review and evaluate Bank’s internal capital adequacy assessments and strategies, as well as their ability to monitor and ensure their compliance with regulatory capital ratios. Supervisors should take appropriate supervisory action if they are not satisfied with the result of this process.

**Principle 3:** Supervisors should expect banks to operate above the minimum regulatory capital ratios and should have the ability to require banks to hold capital in excess of the minimum.
Principle 4: Supervisors should seek to intervene at an early stage to prevent capital from falling below the minimum levels required to support the risk characteristics of a particular bank and should require rapid remedial action if capital is not maintained or restored.

Third Pillar: Market Discipline

- Disclosure Requirements
- Guiding Principles
- Achieving Appropriate Disclosure

BASEL - III

Basel III or Basel 3 released in December, 2010 is the third in the series of Basel Accords. These accords deal with risk management aspects for the banking sector. So we can say that Basel III is the global regulatory standard on bank capital adequacy, stress testing and market liquidity risk. (Basel I and Basel II are the earlier versions of the same, and were less stringent).

The RBI issued Guidelines based on the Basel III reforms on capital regulation on May 2 2012, to the extent applicable to banks operating in India. The Basel III capital regulation has been implemented from April 1, 2013 in India in phase and it will be fully implemented as on March 31, 2019 but Extended.

- In Basel 3, implementation of CCB extended from 31.03.20 to 30.09.20 (further changed to 1.4.2021).
- In Basel 3, implementation of NSFR extended from 1.4.20 to 1.10.20 (further changed to 1.4.2021)

Aims of the Basel III

- Improve the banking sector’s ability to absorb ups and downs arising from financial and economic instability
- Improve risk management ability and governance of banking sector
- Strengthen banks’ transparency and disclosures
**What are the major changes proposed in Basel iii over earlier accords i.e. Basel I and Basel II?**

**Better Capital Quality:** One of the key elements of Basel 3 is the introduction of much stricter definition of capital. Better quality capital means the higher loss-absorbing capacity. This in turn will mean that banks will be stronger, allowing them to better withstand periods of stress.

**Capital Conservation Buffer:** Another key feature of Basel iii is that now banks will be required to hold a capital conservation buffer of 2.5%. The aim of asking to build conservation buffer is to ensure that banks maintain a cushion of capital that can be used to absorb losses during periods of financial and economic stress.

**Countercyclical Buffer:** This is also one of the key elements of Basel III. The countercyclical buffer has been introduced with the objective to increase capital requirements in good times and decrease the same in bad times. The buffer will slow banking activity when it overheats and will encourage lending when times are tough i.e. in bad times. The buffer will range from 0% to 2.5%, consisting of common equity or other fully loss-absorbing capital.

**Minimum Common Equity and Tier 1 Capital Requirements:** The minimum requirement for common equity, the highest form of loss-absorbing capital, has been raised under Basel III from 2% to 4.5% of total risk-weighted assets. The overall Tier 1 capital requirement, consisting of not only common equity but also other qualifying financial instruments, will also increase from the current minimum of 4% to 6%. Although the minimum total capital requirement will remain at the current 8% level, yet the required total capital will increase to 10.5% when combined with the conservation buffer.

**Leverage Ratio:** A review of the financial crisis of 2008 has indicted that the value of many assets fell quicker than assumed from historical experience. Thus, now Basel III rules include a leverage ratio to serve as a safety net. A leverage ratio is the relative amount of capital to total assets (not risk-weighted). This aims to put a cap on swelling of leverage in the banking sector on a global basis. 3% leverage ratio of Tier 1 will be tested before a mandatory leverage ratio is introduced in January 2018.

**Liquidity Ratios:** Under Basel III, a framework for liquidity risk management will be created. A new Liquidity Coverage Ratio (LCR) and Net Stable Funding Ratio (NSFR) are to be introduced in 2015 and 2018, respectively.

**Systemically Important Financial Institutions (SIFI):** As part of the macro-prudential framework, systemically important banks will be expected to have loss-absorbing capability beyond the Basel III requirements. Options for implementation include capital surcharges, contingent capital and bail-in-debt.
## Comparison of Capital Requirements under Basel II and Basel III

As a percentage of risk weighted assets

<table>
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<tr>
<th></th>
<th>Basel II</th>
<th>Basel III (January 2019)</th>
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<tbody>
<tr>
<td>A= (B+D) Minimum Total Capital</td>
<td>8.0</td>
<td>8.0</td>
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<tr>
<td>B Minimum Tier 1 Capital</td>
<td>4.0</td>
<td>6.0</td>
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<tr>
<td>C Of which: Minimum common equity Tier 1 capital</td>
<td>2.0</td>
<td>4.5</td>
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<tr>
<td>D Maximum Tier 2 Capital (Within Total capital)</td>
<td>4.0</td>
<td>2.0</td>
</tr>
<tr>
<td>E Capital conservation buffer (CCB)</td>
<td>--</td>
<td>2.5</td>
</tr>
<tr>
<td>F=C+E Minimum Common Equity Tier 1 capital +CCB</td>
<td>2.0</td>
<td>7.0</td>
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<tr>
<td>G=A+E Minimum Total capital +CCB</td>
<td>8.0</td>
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### Minimum Regulatory Capital Prescriptions (as percentage of risk weighted assets)

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<tr>
<td>C Of which: Minimum common equity Tier 1 capital</td>
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<td>5.5</td>
<td>4.5</td>
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<td>D Maximum Tier 2 Capital (Within Total capital)</td>
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<td>2.0</td>
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### Unit- 9 Alliances/Mergers/Consolidation

#### Alliances

A strategic alliance is a formal and *mutually agreed to* commercial collaboration between companies. It is a synergistic arrangement whereby two or more organizations agree to cooperate in the operation of a business activity, where each involved company brings different strengths and capabilities to the arrangement. Alliance can be equity based or non-equity based.

**Strategic Alliances-Benefits**

- Allocation of funds for research
- Ability to bring together, complementary skills
- Rapidly achieve scale and momentum
- Providing added value to customers
- Reduce transaction cost through outsourcing, leveraging of synergy

#### Merger

Merger, also known as amalgamation, is defined as the unification of two or more companies into a single company, where one survives with its name and the others lose their corporate existence.

**Examples:** Canara Bank merged with Syndicate Bank

**Objectives:**

- Diversification of areas of activity

### Table

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<tr>
<th></th>
<th>Capital conservation buffer (CCB)</th>
<th>Minimum Common Equity Tier 1 capital + CCB</th>
<th>Minimum Total capital + CCB</th>
<th>Leverage Ratio (Ratio to total Assets)</th>
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<td>2.5</td>
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<td>G=A+E</td>
<td>Minimum Total capital + CCB</td>
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<td>11.5</td>
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<td>--</td>
<td>4.5</td>
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</table>
• Improve profitability
• Achieve economies of scale
• Acquiring assets at lower than market price

**Types of Merger:**

- **Horizontal** – Involves the merger of two or more companies which are producing similar products or rendering the same type of services. It results in reduction of players.
- **Vertical** – It involves the merger of two companies, where one of them is an actual or potential supplier of goods or services to the other. It results in outlet for products and the effect may improve efficiency.

- **Extension** – It involves merger of two companies that are related through the basic technologies, production process or markets. It provides an extension of product line, market participations or technology to the surviving company.
- **Conglomerate** – It neither constitute the bringing together of competitors nor have a vertical connection. It involves a predominant element of diversification of activities. In this kind of merger, one company derives most of its revenue from a particular industry, acquiring companies operating in other industries – with a view to obtain greater stability of earnings through diversification.

**Advantages of merger** -

- Brings synergy in operations
- Economies of scale
- Growth in top line and bottom line
- Opportunities to penetrate markets
- Facilitates product innovation

**Disadvantages of merger** -

- Dilution of competition
- Abuse of market power through monopoly
- Larger potential for systematic risk

**Acquisition or Take Over**

Acquisition or take over of a company refers to the acquiring of a controlling stake in the ownership of a company by another entity.

**Consolidation**
Consolidation is combining of two existing companies into one. Both existing companies extinguish and new one is created, asset and liabilities of both are combined into a new company.

**Consolidation in Indian Banking**

- Consolidation in Indian banking started in **1921 when 3 presidency banks (Bank of Bengal, Bank of Bombay and Bank of Madras)** were amalgamated into Imperial Bank of India (later converted as SBI).
- **In 1993, New Bank of India was merged with PNB.**
- In subsequent years many mergers took place including latest merger of State bank associate with SBI in 2017.
- **U/s 45 of BR Act, RBI can recommend compulsory amalgamation of banks, in public interest. Such mergers are normally based on weak financial of the bank to be merged.**
- The process of merger of RRBs have been merged on State-wide basis or with their sponsor bank, for consolidation.
- **Merger of Banks 2018-** The government had merged **Dena Bank and Vijaya Bank with Bank of Baroda**, creating the third-largest bank.
- **Mega Merger of Banks 2019-** With the mega merger announce on August 30, 2019, ten public sectors banks will be reduced into four large banks.

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**Unit 10- CIBIL, Fair Practices Code for Debt Collection, BCSB**

**CIBIL (Credit Information Bureau (India) Limited)**

CIBIL (Credit Information Bureau (India) Limited) is a Credit Bureau or Credit Information Company. This company is engaged in maintaining the records of all the credit-related activities of companies as well as individuals including credit cards and loans. The registered member banks and several other financial institutions periodically submit their information to CIBIL. Based on the information and record provided by these institutions, CIBIL issues a CIR (Credit Information Report) as well as a credit score.

**Govt. of India enacted an Act called credit Information Companies (regulation) Act in 2005.**

Soon thereafter the RBI issued notification regarding the framework for functioning of credit information bureaus.

As on date the RBI has issued authorization to 4 credit information companies to operate. A credit information company (CIC) or popularly known as credit bureau collects the credit information from bank and other lenders, prepares a credit history, compiles credit scores and thereafter provides the information on a particular proponent to the lender for a fee. The
information provided by CIC helps the lender to take an objective decision, quickly, based on the information which include data such as loans credit card facilities availed from one or different lenders, re-payment record, current balance on each of the facility, new credit hungry), defaults in repayment of dues, suit filed information etc.

**Membership to a CIC**

Credit Institutions (Banks, RRBs, Co-operative banks, NBFC, Public Financial Institution, Housing Financial Institution etc. Companies engaged in the business of credit cards and other similar cards and companies dealing with distribution of credit in any other manner or any other institution which the Reserve Bank may specify, from time to time, for this purpose), Insurance Companies, Companies providing cellular or telephone services, Credit Rating Agencies, Asset Reconstruction Companies.

**Product offerings by CIBIL**

CIBIL offers three products viz. **credit score, a credit report for individuals and credit report for companies:**

**Credit score**

Credit score refers to a **3 digit numeric value** which represents the creditworthiness of an individual. The creditworthiness ranges **between 300 to 900 with 900 being the highest and 300 being the least.** This score is computed with the help of the credit history of an individual. Banks and most of the financial institutions prefer extending credit to an individual whose score is **750 and more.** Individuals with good credit scores are less likely to default on their loan payments.

**Credit report**

Credit report contains the credit information that **CIBIL fetches from various financial institutions.** This detailed report contains information about an individual’s history of borrowing and repayment routine, including defaults and delays. The important parts of this report are credit Score, individual’s personal information, employment details, contact information and account details.

**Credit report for companies**

Credit report for companies constitutes details about a company’s credit history. The several segments in a company credit report speak about potential lenders, existing credit which the company has, any pending lawsuits and outstanding amount. A good credit report is essential for approval of any loans, whereas a bad report could damage/reduce the chances of the loan being granted to the company.

**Fair Practices Code for Debt Collection**
Demand for Lenders Liability Law

The Securitisation and Reconstruction of Financial Asset and Enforcement of Security Interest Act was enacted in India in 2002. The Act allowed banks to take possession of assets of defaulting companies without going through the cumbersome legal process. In many countries, banks are mandated by law to respect the right and interest of borrowers, depositors and the other customers.

All the banks in India have framed their own set of fair practices codes as per the guidelines and implemented it from November 1, 2003.

The ‘Code of Bank’s Commitment to Customers’ was released by Dr. Y.V Reddy, the then Governor, Reserve Bank of India, in an inaugural function held at RBI on 1 July, 2006.

Application for Loans and their Processing

(a) Loan application form in respect of priority sector and advances of up to Rs. 2 lakhs should be comprehensive. It should include information about the fees/charges, if any, payable for processing. The amount of such fees is refundable in the case of non-acceptance of application. A meaningful comparison with that of other banks can thus be made and the informed decision can be taken by the borrower.

(b) Banks and financial institutions shall give acknowledgement for receipt of all loan applications. The time frame, within which loan application up Rs 2 lakhs will be disposed, should also be indicated in acknowledgement of such applications.

(c) Banks/financial institutions should scrutinize the loan application within a reasonable period of time. If additional details/documents are required, they should intimate the borrowers immediately.

(d) In the case of small borrowers seeking loans up to Rs 2 lakhs, the lenders should convey in writing, the main reason/ reasons which, in the opinion of the bank after due consideration, have led to rejection of the loan applications within the stipulated time.

Banking Codes and Standards Board of India (BCSBI)

In November 2003, RBI constituted the Committee on Procedures and Performance Audit of Public Services under the Chairmanship of Shri. S.S Tarapore (Former Deputy Governor) to address the issues relating to availability of adequate banking services to the common man. The mandate to the committee included identification of factors that inhibited the attainment of best customer services and suggestion steps to improve the quality of banking services to individual customers.
The Banking Codes and Standards Board of India (BCSBI) is an independent banking industry watchdog that protects consumers of banking services in India. The board oversee compliance with the "Code of Bank's Commitment to Customers". It is not a compensation mechanism and looks into an individual complaint only to the extent it points to any systemic compliance failure. It is an independent and autonomous body, registered as a separate society under the Societies Registration Act, 1860 on 18 February 2006. The Reserve Bank of India extended financial support to the Board, meeting its expenses for the first five years.

Main aims

- The plan, evolve, prepare, develop, promote and publish voluntary, comprehensive Code and Standards for banks, to provide fair treatment to their customers.
- To function as an independent and autonomous watchdog to monitor and ensure that the Codes and Standards are adhered to.
- To conduct and undertake research of Codes and Standards currently in use around the world.
- To enter into covenants with banks on observance of codes and standards and to train employees of such banks about the Codes.
- To help people affected by natural calamities.

Monitoring of Implementation of the Code

BCSBI monitors the implementation of the codes through the following methods:

(a) Obtains from member banks an Annual Statement of Compliance (ASC)
(b) Visits branches to find out the status of ground-level implementation of Codes
(c) Studies complaints received from customers and order/awards issued by Banking Ombudsmen/ Appellate Authority to find out whether there is any system-wide deficiency.
(d) Organizes an annual conference with Principal Code Compliance officers of the Member banks to discuss implementation issues.

Initiatives by BCSBI

BCSBI Also undertakes campaigns and initiatives to spread awareness of the Codes amongst customers and Banks such as:-

(i) Provides faculty support to training establishment of Banks
(ii) Participates in On- location workshops held by member banks to increase coverage
(iii) Associate with customer awareness Programmes conducted by Banking Ombudsmen
(iv) Provide Credit counseling services in Mumbai
(v) Publishes quarterly newsletter entitled “Customer Matter” containing matters of interest to customers

**Unit 9- Recent Developments in the Financial System**

Indian Government appointed a committee under the chairmanship of Sukhamoy Chakravarty in 1985 to review the Indian monetary system. Later, working group on the money market (Chairmanship of Narayanan Vaghul, 1988), a number of measures were taken up by the RBI to widen and deepen the money market through institution jointly by RBI, Public sector bank and financial institutions, commenced operations in April 1988, to deal in short term money market instruments with the primary objective of improving liquidity. The introduction of new instruments, broadening of participants base and strengthening of institutional infrastructure have been pursued during the 1990s, based on the framework provided by the Narayanan Vaghul and the Narasimham Committee II.

As per the recommendations of these study groups and with the financial sector reforms initiated in the early 1990s, the government has adopted following major reforms in the Indian money market.

i) Deregulation of the Interest Rate
ii) Money Market Mutual Fund (MMMFs)
iii) Liquidity Adjustment Facility (LAF)
iv) Electronic Transactions
v) Establishment of the CCIL

iv) Development of New Market Instruments : The government has consistently tried to introduce new short-term investment instruments. Examples: Treasury Bills of various duration, Commercial papers, Certificates of Deposits, MMMFs, etc. have been introduced in the Indian Money Market.

**Commercial paper**

Commercial paper is an unsecured money market instrument issued in the form of a Promissory note was introduced in India in 1990. It enables highly rated corporate borrowers to diversify their sources of short-term borrowings and to provide an additional instrument to investors. Information on CP issuance as reported by the Issuing and Paying Agents (IPAs) on
the NDS platform has been made available on the Reserve Bank’s website with effect from July 2005, to enhance transparency and facilitate wider dissemination.

**Maturity**

- Minimum: 7 days
- Maximum: 1 year

**Certificate of deposit**

A certificate of deposit is a negotiable money market instrument which is issued in dematerialised form or as a Usance Promissory Note, for funds deposited at a bank or other eligible financial institution for a specified time period. CD were introduced in India in 1989. The minimum maturity period of CP is 7 days with effect from 29 Apr 2005.

**Maturity**

- Minimum: 7 days
- Maximum: 1 year

**Note:** FIs can issue CDs for a period not exceeding 3 years from the date of issue.

The Reserve Bank has taken many initiatives towards introducing and upgrading safe and efficient modes of payment systems in the country to meet the requirements of the public at large.

Since paper based payments occupy an important place in the country, Reserve Bank had introduced Magnetic Ink Character Recognition (MICR) technology for speeding up and bringing in efficiency in processing of cheques.

Later, a separate High Value Clearing was introduced for clearing cheques of value Rupees one lakh and above. This clearing was available at select large centres in the country (since discontinued).

Recent developments in paper-based instruments include launch of Speed Clearing (for local clearance of outstation cheques drawn on core-banking enabled branches of banks), introduction of cheque truncation system (to restrict physical movement of cheques and enable use of images for payment processing), framing CTS-2010 Standards (for enhancing the security features on cheque forms) and the like.
In pursuance of the recommendations of the committee on banking sector reforms (Chairmanship M. Narasimham, 1998), the process of transforming the call/notice money market into a pure inter-bank market was **completed in August 2005.**

**Payment and Settlement Systems:** In India, the payment and settlement system are regulated by the **Payment and Settlement systems Act, 2007 (PSS Act)** which was legislated in December 2007. The PSS Act as well as the Payment and Settlement System Regulations, 2008 came into effect from **August 12, 2008.** In terms of section 4 of the PSS act, no person other than the RBI can commerce or operate a payment system in India unless **authorized by RBI.** RBI has since authorized payment system operator of pre-paid payment instruments, card schemes, cross border in bound money transfer, Automated Teller Machine networks and centralized clearing arrangements.

**Electronic Payments:** The continued increase in the volume of cheques added pressure on the existing set-up, thus necessitating following cost-effective alternative systems.

i) **Electronic Clearing Service (ECS) Credit:** The RBI introduced the ECS (Credit) scheme during the 1990s to handle bulk and repetitive payment requirements (like salary, interest, Dividend payments) of corporates and other institutions. During September 2008, the RBI launched a new service known as **National Electronic Clearing Service (NECS)**, at National clearing Cell (NCC), Mumbai. NECS (credit) facilitates **multiple credits to beneficiary accounts with destination branches across** the country against a single debit of the account of the sponsor bank.

ii) **Regional ECS (RECS):** RECS has been launched during the year 2009. RECS, a miniature of the NECS is confined to the bank branches within the jurisdiction of a Regional Office of RBI.

iii) **Electronic Clearing Service (ECS) Debit:** The ECS scheme was introduced by RBI to provide a faster method of effecting periodic and repetitive collections of utility companies.

iv) **National Electronic Funds Transfer (NEFT) System:** In November 2005, a more secure system was introduced for facilitating one to one funds transfer requirement of individuals/Corporates.

v) **Real Time Gross Settlement (RTGS) System:** This was introduced in 2004 and settles all inter-bank payments and customer transactions above Rs 2 lakhs.

vi) **Clearing Corporation of India Limited (CCIL):** CCIL was setup in April 2001 by banks, financial institutions and primary dealers, to function as an industry services organization for clearing and settlement of trades in money market, government securities and foreign exchange markets.
vii) Electronic Funds Transfer: This retail fund transfer system introduced in the 1990s enabled an account holder of bank to electronically transfer funds to another holder with any other participating bank.

**Other Payment Systems**

**Pre-paid Payment systems**

Pre-paid instruments are payment instruments that facilitate purchase of goods and services against the value stored on these instruments. The value stored on such instruments represents the value paid for by the holders by cash, by debit to a bank account, or by credit card. The pre-paid payment instruments can be issued in the form of smart cards, magnetic stripe cards, internet accounts, internet wallets, mobile accounts, mobile wallets, paper vouchers, etc.

The use of pre-paid payment instruments for cross border transactions has not been permitted, except for the payment instruments approved under Foreign Exchange Management Act, 1999 (FEMA).

Reserve Bank brought out a set of operating guidelines on mobile banking for banks in October 2008, according to which only banks which are licensed and supervised in India and have a physical presence in India are permitted to offer mobile banking after obtaining necessary permission from Reserve Bank.

**ATMs / Point of Sale (POS) Terminals / Online Transactions**

As on Feb, 2014, there are over 1,50,008 ATMs (76836 onsite and 73172 offsite) in India. Savings Bank customers can withdraw cash from any bank terminal up to 5 times in a month without being charged for the same (refer RBI circulars for latest changes).

Reserve Bank has mandated re-crediting of failed transactions within 7 working day and mandated compensation for delays beyond the stipulated period.

As on Feb, 2014, there are over 10 lakh POS terminals in the country, which enable customers to make payments for purchases of goods and services by means of credit/debit cards.

To facilitate customer convenience the Bank has also permitted cash withdrawal using debit cards issued by the banks at PoS terminals.

Further, to reduce the risks arising out of the use of credit/debit cards over internet/IVR (technically referred to as card not present (CNP) transactions), Reserve Bank mandated that all CNP transactions should be additionally authenticated based on information not available on the card and an online alert should be sent to the cardholders for such transactions.
National Payments Corporation of India

The Reserve Bank encouraged the setting up of National Payments Corporation of India (NPCI) to act as an umbrella organisation for operating various Retail Payment Systems (RPS) in India. **NPCI became functional in early 2009.** NPCI has taken over National Financial Switch (NFS) from Institute for Development and Research in Banking Technology (IDRBT).

Oversight of the payment and settlement systems is a central bank function whereby the objectives of safety and efficiency are promoted by monitoring existing and planned systems, assessing them against these objectives and, where necessary, inducing change. By overseeing payment and settlement systems, central banks help to maintain systemic stability and reduce systemic risk, and to maintain public confidence in payment and settlement systems.

“Rupay” is the country’s own card payment network developed by National Payments Corporation of India (NPCI). It was dedicated to the national by the Hon. Former President of India Shri Pranab Mukherjee on May 8, 2014. “Rupay” minimize the dependency on the international schemes.

The Depositor Education and Awareness Fund Scheme, 2014

Pursuant to the amendment of the Banking Regulation Act 1949, section 26A has been interest in that Act, empowering Reserve Bank to establish The Depositor Education and Awareness Fund (The Fund). Under the provisions of this section the amount to the credit of any account of the credit of any account in India with any bank which has been operated upon for a period of ten years or any deposit or any amount remaining unclaimed for more than 10 years shall be credited to the fund, within a period of 3 months from the expiry of the said period 10 years.

Transfer of Funds

- The amount to be credited to the fund includes credit balance in any deposit account maintained with banks with have not been operated upon for ten years or more, or any amount remaining unclaimed for **10 years or more as under**:-
  - Saving bank deposit account
  - Fixed or term deposit account
  - Cumulative/ recurring deposit accounts
  - Current deposit accounts
  - Other deposit accounts in any form or with any name
  - Cash credit accounts
  - Loan accounts after due appropriation by the bank
- Margin money against issue of letter of credit/ Guarantee etc any security deposit etc.

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