INDIAN FINANCIAL SYSTEM

The structure of the Indian financial system may be summarized in the following schematic representation. Broadly the Indian financial system may be divided into organized and unorganized segments. The organized market consists of commercial banks, development banks, cooperative banks, post-office savings bank operations, stock markets etc. Unorganised financial market operations consist of hundis, money-lending, chit funds etc. They operate mainly in the rural areas. However in the urban areas also unorganized money market activities are quite significant. There is no precise estimate of the size of the unorganized money market. It is generally expected that the relative size of the unorganized money market transactions would decline over time.

Definition of Financial System

"It is a set of institutions instruments and markets which fosters saving and channels them to their most efficient use".- **H.R. Machiraju.**

"Financial system allocates savings efficiently in an economy to ultimate users either for investment in real assets or for consumption". - **Van Horne.**

"Financial system consists of a variety of institutions, markets and instruments related in a systematic manner and provides the principal means by which savings are transformed into investments". - **Prasanna Chandra.**

Role and Importance of Financial System in Economic Development:

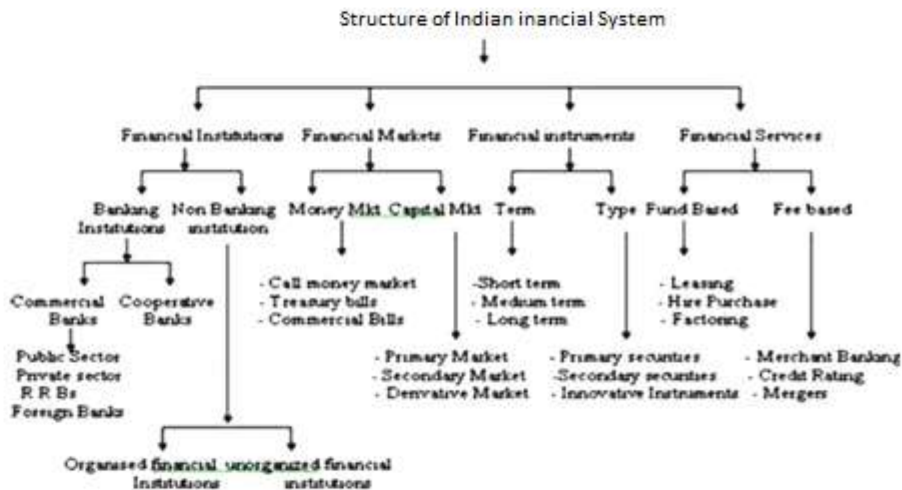
1. It links the savers and investors. It helps in mobilizing and allocating the savings efficiently and effectively. It plays a crucial role in economic development through saving-investment process. This savings – investment process is called capital formation.
2. It helps to monitor corporate performance.
3. It provides a mechanism for managing uncertainty and controlling risk.
4. It provides a mechanism for the transfer of resources across geographical boundaries.
5. It offers portfolio adjustment facilities (provided by financial markets and financial intermediaries).
6. It helps in lowering the transaction costs and increase returns. This will motivate people to save more.
7. It promotes the process of capital formation.
8. It helps in promoting the process of financial deepening and broadening.

FUNCTIONS OF FINANCIAL SYSTEM: The financial system of a country performs certain valuable functions for the economic growth of that country. The main functions of a financial system may be briefly discussed as below:

1. **Saving function:** An important function of a financial system is to mobilize savings and channelize them into productive activities. It is through financial system the savings are transformed into investments.
2. **Liquidity function**: The most important function of a financial system is to provide money and monetary assets for the production of goods and services. Monetary assets are those assets which can be converted into cash or money easily without loss of value. All activities in a financial system are related to liquidity-either provision of liquidity or trading in liquidity.
3. **Payment function:** The financial system offers a very convenient mode of payment for goods and services. The cheque system and credit card system are the easiest methods of payment in the economy. The cost and time of transactions are considerably reduced.
4. **Risk function**: The financial markets provide protection against life, health and income risks. These guarantees are accomplished through the sale of life, health insurance and property insurance policies.
5. **Information function:** A financial system makes available price-related information. This is a valuable help to those who need to take economic and financial decisions. Financial markets disseminate information for enabling participants to develop an informed opinion about investment, disinvestment, reinvestment or holding a particular asset.
6. **Transfer function:** A financial system provides a mechanism for the transfer of the resources across geographic boundaries.
7. **Reformatory functions:** A financial system undertaking the functions of developing, introducing innovative financial assets/instruments services and practices and restructuring the existing assts, services etc, to cater the emerging needs of borrowers and investors (financial engineering and re engineering).
8. **Other functions:** It assists in the selection of projects to be financed and also reviews performance of such projects periodically. It also promotes the process of capital formation by bringing together the supply of savings and the demand for investible funds.

Structure of the Indian Financial System. This includes:

1. Financial Institutions
2. Financial Markets
3. Financial Assets
4. Financial Services



Financial Institutions The Financial Institutions act as a mediator between the investor and the borrower. The investor's savings are mobilized either directly or indirectly via the Financial Markets.

The main functions of the Financial Institutions are as follows:

- A short term liability can be converted into a long term investment
- It helps in conversion of a risky investment into a risk-free investment
- Also acts as a medium of convenience denomination, which means, it can match a small deposit with large loans and a large deposit with small loans

The best example of a Financial Institution is a Bank. People with surplus amounts of money make savings in their accounts, and people in dire need of money take loans. The bank acts as an intermediate between the two.

The financial institutions can further be divided into two types:

- **Banking Institutions or Depository Institutions** – This includes banks and other credit unions which collect money from the public against interest provided on the deposits made and lend that money to the ones in need
- **Non-Banking Institutions or Non-Depository Institutions** – Insurance, mutual funds and brokerage companies fall under this category. They cannot ask for monetary deposits but sell financial products to their customers.

Further, Financial Institutions can be classified into three categories:

- **Regulatory** – Institutes that regulate the financial markets like RBI, IRDA, SEBI, etc.
- **Intermediates** – Commercial banks which provide loans and other financial assistance such as SBI, BOB, PNB, etc.
- **Non Intermediates** – Institutions that provide financial aid to corporate customers. It includes NABARD, SIBDI, etc.

1. **Financial Markets** The marketplace where buyers and sellers interact with each other and participate in the trading of money, bonds, shares and other assets is called a financial market.

   The financial market can be further divided into four types:

   - **Capital Market –** Designed to finance the long term investment, the Capital market deals with transactions which are taking place in the market for over a year. The capital market can further be divided into three types:
     a) Corporate Securities Market
     b) Government Securities Market
     c) Long Term Loan Market
   - **Money Market –** Mostly dominated by Government, Banks and other Large Institutions, the type of market is authorised for small-term investments only. It is a wholesale debt market which works on low-risk and highly liquid instruments. The money market can further be divided into two types:
     a) Organised Money Market
     b) Unorganised Money Market
   - **Foreign exchange Market –** One of the most developed markets across the world, the Foreign exchange market, deals with the requirements related to multi-currency. The transfer of funds in this market takes place based on the foreign currency rate.
   - **Credit Market –** A market where short-term and long-term loans are granted to individuals or Organisations by various banks and Financial and Non-Financial Institutions is called Credit Market

2. **Financial Assets** The products which are traded in the Financial Markets are called Financial Assets. Based on the different requirements and needs of the credit seeker, the securities in the market also differ from each other.

   Some important Financial Assets are-

   a) **Call Money –** When a loan is granted for one day and is repaid on the second day, it is called call money. No collateral securities are required for this kind of transaction.
   b) **Notice Money –** When a loan is granted for more than a day and for less than 14 days, it is called notice money. No collateral securities are required for this kind of transaction.
   c) **Term Money –** When the maturity period of a deposit is beyond 14 days, it is called term money.

d) **Treasury Bills** – Also known as T-Bills, these are Government bonds or debt securities with maturity of less than a year. Buying a T-Bill means lending money to the Government.

e) **Certificate of Deposits** – It is a dematerialised form (Electronically generated) for funds deposited in the bank for a specific period of time.

f) **Commercial Paper** – It is an unsecured short-term debt instrument issued by corporations.

3. **Financial Services** Services provided by Asset Management and Liability Management Companies. They help to get the required funds and also make sure that they are efficiently invested.

The financial services in India include:

a) **Banking Services** – Any small or big service provided by banks like granting a loan, depositing money, issuing debit/credit cards, opening accounts, etc.

b) **Insurance Services** – Services like issuing of insurance, selling policies, insurance undertaking and brokerages, etc. are all a part of the Insurance services

c) **Investment Services** – It mostly includes asset management

d) **Foreign Exchange Services** – Exchange of currency, foreign exchange, etc. are a part of the Foreign exchange services

The main aim of the financial services is to assist a person with selling, borrowing or purchasing securities, allowing payments and settlements and lending and investing.

Weaknesses Of Indian Financial System

Even though Indian financial system is more developed today, it suffers from certain weaknesses. These may be briefly stated below:

1. **Lack of co-ordination among financial institutions:** There are a large number of financial intermediaries. Most of the financial institutions are owned by the government. At the same time, the government is also the controlling authority of these institutions. As there is multiplicity of institutions in the Indian financial system, there is lack of co-ordination in the working of these institutions.
2. **Dominance of development banks in industrial finance**: The industrial financing in India today is largely through the financial institutions set up by the government. They get most of their funds from their sponsors. They act as distributive agencies only. Hence, they fail to mobilise the savings of the public. This stands in the way of growth of an efficient financial system in the country.

3. **Inactive and erratic capital market**: In India, the corporate customers are able to raise finance through development banks. So, they need not go to capital market. Moreover, they do not resort to capital market because it is erratic and enactive. Investors too prefer investments in physical assets to investments in financial assets.
4. **Unhealthy financial practices**: The dominance of development banks has developed unhealthy financial practices among corporate customers. The development banks provide most of the funds in the form of term loans. So there is a predominance of debt in the financial structure of corporate enterprises. This predominance of debt capital has made the capital structure of the borrowing enterprises uneven and lopsided. When these enterprises face financial crisis, the financial institutions permit a greater use of debt than is warranted. This will make matters worse.
5. **Monopolistic market structures**: In India some financial institutions are so large that they have created a monopolistic market structures in the financial system. For instance, the entire life insurance business is in the hands of LIC. The weakness of this large structure is that it could lead to inefficiency in their working or mismanagement. Ultimately, it would retard the development of the financial system of the country itself.
6. **Other factors:** Apart from the above, there are some other factors which put obstacles to the growth of Indian financial system. Examples are:
   a) Banks and Financial Institutions have high level of NPA.
   b) Government burdened with high level of domestic debt.
   c) Cooperative banks are labeled with scams.
   d) Investors confidence reduced in the public sector undertaking etc
   e) Financial illiteracy.

In the recent past, the most notable aspect of Indian economy is its financial system. Perhaps no system in the world has changed so much as that of our financial system. Indian financial system undergoing fast development and hence not matured like that of developed countries. The government should take reasonable reforms to mould our financial system as healthy one.

BANKING SYSTEM IN INDIA

The Indian banking sector is broadly classified into scheduled banks and non-scheduled banks. All banks included in the Second Schedule to the Reserve Bank of India Act, 1934 are Scheduled Banks. These banks comprise Scheduled Commercial Banks and Scheduled Co-operative Banks.

Banking

Banking refers to the system of financial institutions, such as banks and credit unions, that provide various financial services to individuals, businesses, and governments. Banking services

mainly include accepting deposits, lending money, facilitating transactions, and offering various financial products like savings accounts, loans, and credit cards.

Banking plays a crucial role in the economy by facilitating the flow of money and enabling economic activities.

Functions of Banks

Major functions of banks are mentioned below:

- Accepting Deposits:
- Advancing Cash.
- Currency Exchange
- Agency Services
- Miscellaneous Services

Types of Banks in India

The Banking System in India is divided into several types, each serving specific functions and purposes. The table below represents the different types of banks in India and how it is further divided:

Banking Classification in India	
Types of Banks	Sub-types
Central Bank	-
Commercial Banks	a) Private Sector Banks b) Public Sector Banks c) Regional Rural Banks d) Foreign Banks
Co-operative Banks	a) State Co-operative Banks b) Urban Co-operative Banks
Payment Banks	The payment banks are a relatively new banking model in the country that has been conceptualised by the RBI. This bank is allowed to accept a restricted deposit. This amount is limited to Rs. 1 lakh for a customer. The bank also offers services such as ATM cards, net banking and more.

Small Finance Banks	These banks primarily serve the unserved and underserved sections of the population, including small businesses and low-income individuals.
Scheduled Banks	These banks are covered under the 2nd Schedule of RBI Act 1934, and they need to have a paid-up capital of Rs. 5 lahks or more.
Non-scheduled Banks	The non-scheduled banks are local area banks that are not listed in the 2nd Schedule of the RBI Act 1934.

1) Central Bank

The Reserve Bank of India (RBI) serves as the Central Bank of India and is responsible for regulating and controlling the monetary and banking system in the country.

2) Commercial Banks

These are the most common types of banks and include public sector banks, private sector banks, and foreign banks. They provide various services like savings and current accounts, loans, and investments.

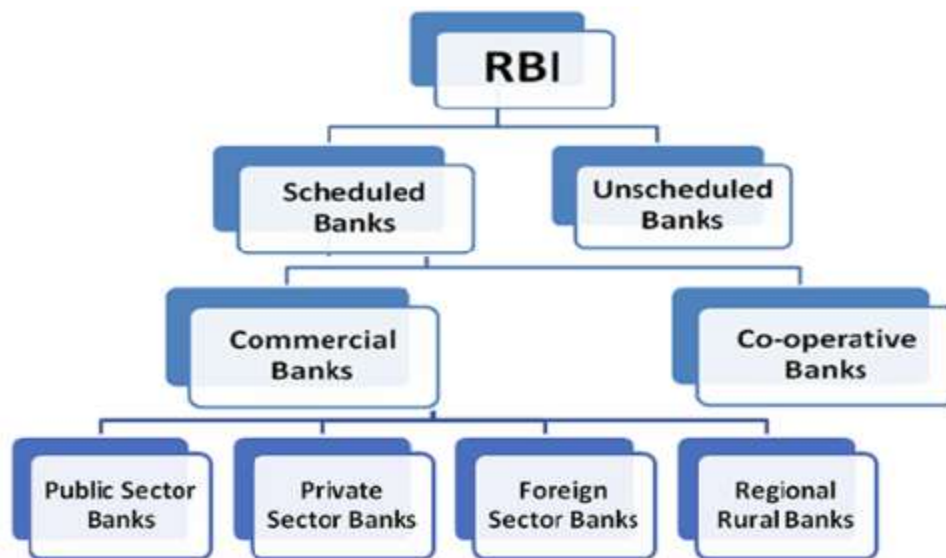
These are the most common types of banks and include public sector banks, private sector banks, and foreign banks. They provide various services like savings and current accounts, loans, and investments.

Public Sector Banks: Owned and operated by the government, examples include State Bank of India (SBI), Punjab National Bank (PNB), and Bank of Baroda (BOB).

Private Sector Banks: These are privately owned and managed banks, such as HDFC Bank, ICICI Bank, and Axis Bank.

Foreign Banks: These banks have branches in India and are headquartered in foreign countries. Some examples are Citibank, Standard Chartered, and HSBC.

Regional Rural Banks (RRBs): These banks cater to rural and semi-urban areas and are owned by the government, commercial banks, and state governments.



The table below shows a few examples of Commercial Banks in India

Public Sector Banks (List of public sector banks)	**Private Sector Banks** (List of private sector banks in India)	**Foreign Banks** (List of foreign banks that operate in India)
Bank of Maharashtra Indian Bank Bank of Baroda Canara Bank State Bank of India Central Bank of India Union Bank of India Indian Overseas Bank UCO Bank Punjab & Sind Bank	I.C.I.C.I. Bank, R.B.L. Bank I.D.F.C. Bank South Indian Bank IDBI Bank Tamilnad Mercantile Bank YES Bank Axis Bank City Union Bank Karnataka Bank Dhanlaxmi Bank Kotak Mahindra Bank D.C.B. Bank Karur Vysya Bank Federal Bank	Australia and New Zealand Banking Group Ltd. National Australia Bank Westpac Banking Corporation Bank of Bahrain & Kuwait BSC AB Bank Ltd. Credit Agricole Corporate & Investment Bank Societe Generale Deutsche Bank HSBC Bank PT Bank Maybank Indonesia TBK Mizuho Bank Ltd. Sumitomo Mitsui Banking Corporation

Bank of India Punjab National Bank	Lakshmi Vilas Bank H.D.F.C. Bank Nainital Bank IndusInd Bank Bandhan Bank Jammu and Kashmir Bank	M.U.F.G. Bank, Ltd. Coöperatieve Rabobank U.A. Sonali Bank Ltd. Bank of Nova Scotia Industrial & Commercial Bank of China Ltd. BNP Paribas Doha Bank Qatar National BanK JSC VTB Bank Sberbank United Overseas Bank Ltd FirstRand Bank Ltd Shinhan Bank Woori Bank Barclays Bank Plc. Standard Chartered Bank The Royal Bank of Scotland plc American Express Banking Corporation Bank of America Citibank J.P. Morgan Chase Bank N.A Kookmin Bank S.B.M. Bank (India) Limited K.E.B. Hana Bank Industrial Bank of Korea Bank of Ceylon D.B.S. Bank India Limited Credit Suisse A.G. C.T.B.C. Bank Co., Ltd. Krung Thai Bank Public Co. Ltd. Abu Dhabi Commercial Bank Ltd.

		Mashreq Bank P.S.C. First Abu Dhabi Bank P.J.S.C. Emirates Bank NBD

Cooperative Banks

A Co-operative Bank is registered under the Co-operative Societies Act of 1912 and is run by an elected managing committee. It works on a non-profit, no-loss basis and mainly serves entrepreneurs, small businesses, self-employment, and more in urban areas.

In rural areas, it mainly functions to finance agriculture-based activities like farming, livestock, and hatcheries.

There are mainly two types of Co-operative Banks:

Types Cooperative Bank	Description
State Co-operative Banks	A State Co-operative Bank is a federation of the central Co-operative banks that will act as a custodian of the Co-operative banking structure in the State.
Urban Co-operative Banks	The Urban Co-operative Bank is the primary Co-operative bank located in urban and semi-urban areas. The banks essentially lent to smaller borrowers, and businesses centred around a community, locality, and more.

4) Payment Banks

The payment banks are a relatively new banking model in the country that has been conceptualised by the RBI. This bank is allowed to accept a restricted deposit. This amount is limited to Rs. 1 lakh for a customer. The bank also offers services such as ATM cards, net banking and more.

5) Small Finance Banks

These banks primarily serve the unserved and underserved sections of the population, including small businesses and low-income individuals.

This type of bank is licensed under Section 22 of the Banking Regulation Act 1949, and it is governed by the Provisions Act of 1934.

Here are a few examples of Small Finance Banks in India:

- AU Small Finance Bank Ltd.
- Utkarsh Small Finance Bank Ltd.
- Fincare Small Finance Bank Ltd.
- Ujjivan Small Finance Bank Ltd.
- Jana Small Finance Bank Ltd.
- ESAF Small Finance Bank Ltd.
- Suryoday Small Finance Bank Ltd.
- Equitas Small Finance Bank Ltd.
- Capital Small Finance Bank Ltd.
- North East Small Finance Bank Ltd.

6) Scheduled Banks

These banks are covered under the 2nd Schedule of RBI Act 1934, and they need to have a paid-up capital of Rs. 5 lahks or more.

7) Non-Scheduled Banks

The non-scheduled banks are local area banks that are not listed in the 2nd Schedule of the RBI Act 1934.

Types of Bank Accounts in India

Banks offer several types of bank accounts to cater to different financial needs. These bank accounts vary from one another based on the purpose, transaction frequency and location.

Given below are the common types of bank accounts in India:

Savings Account: This is a basic account for individuals to save money. It offers interest on deposits and allows limited withdrawals.

Current Account: This type of account is mainly used by businesses. It has zero or very low interest rates but offers more transaction features, making it suitable for frequent transactions.

Fixed Deposit Account: In this account, you deposit a lump sum for a fixed tenure at a higher interest rate compared to savings accounts. Funds are locked in until maturity.

Recurring Deposit Account: It is a savings plan where you deposit a fixed amount every month, and at the end of a specified period, you receive the principal and interest.

NRI (Non-Resident Indian) Account: These are for Indians living abroad. NRE (Non-Resident External), NRO (Non-Resident Ordinary) and FCNR (Foreign Currency Non-Residential) accounts are major types of NRI accounts.

Senior Citizen Savings Account: Created for senior citizens, these accounts offer higher interest rates and additional benefits.

Salary Account: This account is used by an employer to credit the salary of an employee every month. It does not have any minimum balance requirement.

Demat Account: This account is created primarily for holding and trading in securities electronically, such as stocks and bonds.

Joint Account: It is shared by two or more individuals, often used for family or business purposes.

Minor Account: Opened on behalf of minors by parents or guardians. The minor gains control upon reaching a certain age.

Corporate Account: Used by companies and corporations for their banking needs, including payroll and transactions.

Monetary Policy

Monetary policy is adopted by the monetary authority of a country that controls either the interest rate payable on very short-term borrowing or the money supply. The policy often targets inflation or interest rate to ensure price stability and generate trust in the currency.

The monetary policy in India is carried out under the authority of the Reserve Bank of India.

Narrow money is also known as M1 and M2. Broad money means M3 and M4. The liquidity of these grades is decreasing. **M1 is the most liquid and makes transactions the easiest, while M4 is the least liquid.** The most commonly used indicator of the money supply is M3. It is also known as the total amount of financial resources. Let's examine each of them individually:

- **M0 = Reserve Money:** Other names include High-Powered Money, Financial Base, Base Money, etc. M0 is calculated as follows: Money in circulation + Bankers' deposits + Other deposits with RBI. It is the **economic foundation's currency**.
- **M1 = Narrow Money:** Money in circulation plus demand deposits in the banking system (current and savings accounts) plus additional deposits with the Reserve Bank of India.
- **M2 = Narrow Money:** M1 + Post Office Savings, Bank Savings
- **M3 = Broad Money:** M1 + time deposits made with banks.
- **M4= Broad Money:** M3 + any deposits made at post office savings banks.

Types of Monetary Policy

Monetary policies are seen as either expansionary or contractionary depending on the level of growth or stagnation within the economy.

Contractionary

A contractionary policy increases interest rates and limits the outstanding money supply to slow growth and decrease inflation, where the prices of goods and services in an economy rise and reduce the purchasing power of money.

Expansionary

During times of slowdown or a recession, an expansionary policy grows economic activity. By lowering interest rates, saving becomes less attractive, and consumer spending and borrowing increase.

What role does the Monetary Policy Committee play?

The Reserve Bank of India Act, 1934 (RBI Act) was amended by the Finance Act, 2016, to provide for a statutory and institutionalized framework for a Monetary Policy Committee, for maintaining price stability, while keeping in mind the objective of growth. The Monetary Policy

Committee is entrusted with the task of fixing the benchmark policy rate (repo rate) required to contain inflation within the specified target level.

The Government of India, in consultation with RBI, notified the 'Inflation Target' in the Gazette of India dated 5 August 2016 for the period beginning from the date of publication of the notification

Credit Control Policy

Credit control is a monetary policy tool used by the Reserve Bank of India to control the demand and supply of money, or liquidity, in the economy. The Reserve Bank of India (RBI) supervises the credit granted by commercial banks..

Instruments of Monetary Policy The various instruments of monetary policy used by the central bank can be broadly classified into two categories:

1. Quantitative or General Methods: (Quantitative credit control)

The methods used by central bank to influence the total volume of credit in the banking system, are called quantitative methods or general methods of credit control. The important quantitative methods are:

a. Bank Rate,
b. Open Market Operations,
c. Cash Reserve Ratio,
d. Statutory Liquidity Ratio,
e. Repo Rate,
f. Reverse Repo Rate.

2. Qualitative or Selective Methods: (Selective credit control)

The methods used by the central bank to regulate the flow of credit into particular directions of the economy are called qualitative methods of credit control. These methods effect the composition rather than the size of credit in the economy. The important qualitative or selective methods of credit control are;

a. Marginal Requirements,
b. Regulation of Consumer Credit,
c. Credit Rationing,
d. Moral Suasion and
e. Direct Action.

1. Quantitative or General Methods:

a. **Bank Rate Policy:** Also known as the discount rate, bank rates are interest charged by the RBI for providing funds and loans to the banking system. An increase in bank rate increases the cost of borrowing by commercial banks which results in the reduction in credit volume to the banks and hence the supply of money declines. An increase in the bank rate is the symbol of the tightening of the RBI monetary policy.

b. **Open Market Operations:** An open market operation is an instrument which involves buying/selling of securities like government bond from or to the public and banks. The RBI sells government securities to control the flow of credit and buys government securities to increase credit flow.

c. **Cash Reserve Ratio (CRR):** Cash Reserve Ratio is a specified amount of bank deposits which banks are required to keep with the RBI in the form of reserves or balances. The higher the CRR with the RBI, the lower will be the liquidity in the system and vice versa.

d. **Statutory Liquidity Ratio (SLR):** All financial institutions have to maintain a certain quantity of liquid assets with themselves at any point in time of their total time and demand liabilities. This is known as the Statutory Liquidity Ratio. The assets are kept in non-cash forms such as precious metals, bonds, etc.

e. **Repo Rate:** it is the repurchase rate at which the central bank lends short term money to the banks against securities. Reduction in repo rate helps commercial banks to get money at a cheaper rate and an increase in repo rate discourages the commercial banks to borrow money as it becomes expensive.

f. **Reverse Repo Rate:** it is the rate at which banks lends to the RBI. It is mostly done when there is surplus liquidity in the economy

2. Qualitative or Selective Methods:

The qualitative or selective methods are meant to regulate the terms on which the credit is granted in specific sectors. They seek to control the demand for credit for different uses by

I. determining minimum down payments and

II. regulating the period of time over which the loan is to be repaid. Various selective controls are discussed below:

a. **Marginal Requirements:** is the difference between the market value of the security and its maximum loan value. Control over margin requirement means control over down payments that must be made in buying securities on credit. If a security has market value of Rs. 100 and if the margin requirement is 60% the maximum loan value will be Rs. 40. Similarly, a margin requirement of 80% would allow borrowing of only 20% of the price of the security.

Thus, an increase in the margin requirements will reduce the amount that can be borrowed for the purchase of a security.

b. **Regulation of Consumer Credit:** Under the consumer credit system, a certain percentage of the price of the durable goods is paid by the consumer in cash. The balance is financed through the bank credit which is repayable by the consumer in installments. The central bank can control consumer credit (a) by changing the amount that can be borrowed for the purchase of the consumer durables and (b) by changing the maximum period over which the installments can be extended.

c. **Rationing of Credit:** Credit rationing is a selective method of controlling and regulating the purpose for which credit is granted by the commercial banks. Rationing of credit may aim at

    - limiting the maximum loans and advances to the commercial banks, and
    - fixing ceiling for specific categories of loans and advances.

d. **Moral Suasion:** Moral suasion means guiding, requesting, persuading the commercial banks to cooperate with the central bank in implementing its general monetary policy. Through this method central bank mainly uses its moral influence to make the commercial banks follow its policies. For instance, the central bank may request the commercial banks not to grant loans for specific purposes. The effectiveness of this method depends upon the immediate and favourable response from the commercial banks.

e. **Direct Action:** This method is most extensively used by the central bank to enforce both qualitative and quantitative credit controls. Direct action refers to the directions issued by the central bank to the commercial banks regarding their lending and investment policies. Direct action may take different forms:

- The central bank may refuse to rediscount the bills of exchange of commercial banks whose credit policy is not in line with the general monetary policy of the central bank;
- The central bank may charge a penal rate of interest, over and above the bank rate, on the money demanded by the bank beyond the prescribed limit;
- The central bank may refuse to grant more credit to the banks whose borrowings are found to be in excess of their capital and reserves.

Objectives of Monetary Policy

Simply put the main objective of monetary policy is to maintain price stability while keeping in mind the objective of growth as price stability is a necessary precondition for sustainable economic growth.

In India, the RBI plays an important role in controlling inflation through the consultation process regarding inflation targeting. The current inflation-targeting framework in India is flexible.

Goals of Monetary Policy

Inflation Contractionary monetary policy is used to temper inflation and reduce the level of money circulating in the economy. Expansionary monetary policy fosters inflationary pressure and increases the amount of money in circulation.

Unemployment An expansionary monetary policy decreases unemployment as a higher money supply and attractive interest rates stimulate business activities and expansion of the job market.

Exchange Rates The exchange rates between domestic and foreign currencies can be affected by monetary policy. With an increase in the money supply, the domestic currency becomes cheaper than its foreign exchange.

REGULATORY ENVIRONMENT FOR COMMERCIAL BANK

Basic Concepts of Regulatory Environment for Commercial Bank in India and Their Provisions

The RBI is the central bank of India and the primary regulatory authority for banking. An entity intending to carry out banking business in India must obtain a license from the RBI. The RBI has

wide-ranging powers to regulate the financial sector, including prescribing norms for setting up and licensing banks.

Exposure Limits

Lending to a single borrower is limited to 15% of the bank's capital funds (tier 1 and tier 2 capital), which may be extended to 20% in the case of infrastructure projects. For group borrowers, lending is limited to 30% of the bank's capital funds, with an option to extend it to 40% for infrastructure projects. The lending limits can be extended by a further 5% with the approval of the bank's board of directors. Lending includes both fund-based and non-fund-based exposure.

Cash Reserve Ratio (CRR) and Statutory Liquidity Ratio (SLR)

Banks in India are required to keep a minimum of 4% of their net demand and time liabilities (NDTL) in the form of cash with the RBI. These currently earn no interest. The CRR needs to be maintained on a fortnightly basis, while the daily maintenance needs to be at least 95% of the required reserves. In case of default on daily maintenance, the penalty is 3% above the bank rate applied on the number of days of default multiplied by the amount by which the amount falls short of the prescribed level.

Over and above the CRR, a minimum of 22% and a maximum of 40% of NDTL, which is known as the SLR, needs to be maintained in the form of gold, cash or certain approved securities. The excess SLR holdings can be used to borrow under the Marginal Standing Facility (MSF) on an overnight basis from the RBI. The interest charged under MSF is higher than the repo rate by 100 bps, and the amount that can be borrowed is limited to 2% of NDTL. (To learn more about how interest rates are determined, particularly in the U.S., consider reading more about who determines interest rates.)

Provisioning

Non-performing assets (NPA) are classified under 3 categories: substandard, doubtful and loss. An asset becomes non-performing if there have been no interest or principal payments for more than 90 days in the case of a term loan. Substandard assets are those assets with NPA status for less than 12 months, at the end of which they are categorized as doubtful assets. A loss asset is one for which the bank or auditor expects no repayment or recovery and is generally written off the books.

For substandard assets, it is required that a provision of 15% of the outstanding loan amount for secured loans and 25% of the outstanding loan amount for unsecured loans be made. For doubtful assets, provisioning for the secured part of the loan varies from 25% of the outstanding loan for NPAs that have been in existence for less than one year, to 40% for NPAs in existence

between one and three years, to 100% for NPA's with a duration of more than three years, while for the unsecured part it is 100%.

Provisioning is also required on standard assets. Provisioning for agriculture and small and medium enterprises is 0.25% and for commercial real estate it is 1% (0.75% for housing), while it is 0.4% for the remaining sectors. Provisioning for standard assets cannot be deducted from gross NPA's to arrive at net NPA's. Additional provisioning over and above the standard provisioning is required for loans given to companies that have unhedged foreign exchange exposure.

Priority Sector Lending

The priority sector broadly consists of micro and small enterprises, and initiatives related to agriculture, education, housing and lending to low-earning or less privileged groups (classified as "weaker sections"). The lending target of 40% of adjusted net bank credit (ANBC) (outstanding bank credit minus certain bills and non-SLR bonds) – or the credit equivalent amount of off-balance-sheet exposure (sum of current credit exposure + potential future credit exposure that is calculated using a credit conversion factor), whichever is higher – has been set for domestic commercial banks and foreign banks with greater than 20 branches, while a target of 32% exists for foreign banks with less than 20 branches.

The amount that is disbursed as loans to the agriculture sector should either be the credit equivalent of off-balance-sheet exposure or 18% of ANBC – whichever of the two figures is higher. Of the amount that is loaned to micro-enterprises and small businesses, 40% should be advanced to those enterprises with equipment that has a maximum value of 200,000 rupees, and plant and machinery valued at a maximum of half a million rupees, while 20% of the total amount lent is to be advanced to micro-enterprises with plant and machinery ranging in value from just above 500,000 rupees to a maximum of a million rupees and equipment with a value above 200,000 rupees but not more than 250,000 rupees.

The total value of loans given to weaker sections should either be 10% of ANBC or the credit equivalent amount of off-balance sheet exposure, whichever is higher. Weaker sections include specific castes and tribes that have been assigned that categorization, including small farmers. There are no specific targets for foreign banks with less than 20 branches.

The private banks in India until now have been reluctant to directly lend to farmers and other weaker sections. One of the main reasons is the disproportionately higher amount of NPA's from priority sector loans, with some estimates indicating it to be 60% of the total NPAs. They achieve their targets by buying out loans and securitized portfolios from other non-banking

finance corporations (NBFC) and investing in the Rural Infrastructure Development Fund (RIDF) to meet their quota.

New Bank License Norms

The new guidelines state that the groups applying for a license should have a successful track record of at least 10 years and the bank should be operated through a non-operative financial holding company (NOFHC) wholly owned by the promoters. The minimum paid-up voting equity capital has to be five billion rupees, with the NOFHC holding at least 40% of it and gradually bringing it down to 15% over 12 years. The shares have to be listed within three years of the start of the bank’s operations.

The foreign shareholding is limited to 49% for the first five years of its operation, after which RBI approval would be needed to increase the stake to a maximum of 74%. The board of the bank should have a majority of independent directors and it would have to comply with the priority sector lending targets discussed earlier. The NOFHC and the bank are prohibited from holding any securities issued by the promoter group and the bank is prohibited from holding any financial securities held by the NOFHC. The new regulations also stipulate that 25% of the branches should be opened in previously unbanked rural areas.

Willful Defaulters

A willful default takes place when a loan isn’t repaid even though resources are available, or if the money lent is used for purposes other than the designated purpose, or if a property secured for a loan is sold off without the bank's knowledge or approval. In case a company within a group defaults and the other group companies that have given guarantees fail to honor their guarantees, the entire group can be termed as a willful defaulter.

Willful defaulters (including the directors) have no access to funding, and criminal proceedings may be initiated against them. The RBI recently changed the regulations to include non-group companies under the willful defaulter tag as well if they fail to honor a guarantee given to another company outside the group.

INSOLVENCY AND BANKRUPTCY CODE, 2016

The **Insolvency and Bankruptcy Code, 2016** (**IBC**) is an Indian law which creates a consolidated framework that governs insolvency and bankruptcy proceedings for companies, partnership firms, and individuals.

Background

Prior to the IBC, the legislative framework for insolvency and restructuring was fragmented across multiple legislations, such as the Companies Act 2013, the Sick Industrial Companies (Special Provisions) Act, 1985, Securitization and Reconstruction of Financial Assets and Enforcement of Security Interest Act, 2002, the Recovery of Debts due to Banks and Financial Institutions Act (RDDBFI Act), 1993, and others.

History

On 22 August 2014, the Ministry of Finance created the Bankruptcy Legislative Reforms Committee (BLRC). The committee was headed by T. K. Viswanathan, and tasked with drafting a new bankruptcy law. The Committee submitted its report, which included a draft bill, on 4 November 2015. A modified version of the draft bill, after the incorporation of public comments, was introduced in the Sixteenth Lok Sabha Lok Sabha by Finance Minister Arun Jaitley as the Insolvency and Bankruptcy Code, 2015. The bill was tabled on 23 December 2015. A Joint Parliamentary Committee on the Insolvency and Bankruptcy Code, 2015 (JPC) was set up and the bill was referred to it for detailed analysis. The JPC submitted its report, which included a new draft of the Bill, 28 April 2016. It was passed by the Lok Sabha on 5 May 2016, and by the Rajya Sabha on 11 May 2016. Subsequently, it received assent from President Pranab Mukherjee and was notified in The Gazette of India on 28 May 2016.

Early cases

The first insolvency resolution order under this code was passed by National Company Law Tribunal (NCLT) in the case of Synergies-Dooray Automotive Ltd on 14 August 2017. The plea for insolvency was submitted by company on 23 January 2017. The resolution plan was submitted to NCLT within a period of 180 days as required by the code, and the approval for the same was received on 2 August 2017 from the tribunal. The final order was uploaded on 14 August 2017 on the NCLT website.

Key Provisions

Insolvency Resolution : The Code outlines separate insolvency resolution processes for individuals, companies and partnership firms. The process may be initiated by either the debtor or the creditors. A maximum time limit, for completion of the insolvency resolution process, has been set for corporates and individuals. For companies, the process will have to be completed in 180 days, which may be extended by 90 days, if a majority of the creditors agree. For start ups (other than partnership firms), small companies and other companies (with asset less than Rs. 1 crore), resolution process would be completed within 90 days of initiation of request which may be extended by 45 days.

The Insolvency and Bankruptcy Code (Amendment) Act, 2019 has increased the mandatory upper Time limit of 330 days including time spent in legal process to complete resolution process.

Insolvency regulator: The Code establishes the Insolvency and Bankruptcy Board of India, to oversee the insolvency proceedings in the country and regulate the entities registered under it. The Board will have 10 members, including representatives from the Ministries of Finance and Law, and the Reserve Bank of India.

Insolvency professionals: The insolvency process will be managed by licensed professionals. These professionals will also control the assets of the debtor during the insolvency process.

Bankruptcy and Insolvency Adjudicator: The Code proposes two separate tribunals to oversee the process of insolvency resolution, for individuals and companies: (i) the National Company Law Tribunal for Companies and Limited Liability Partnership firms; and (ii) the Debt Recovery Tribunal for individuals and partnerships.

Procedure

Time Limit

The IBC envisions that the entire Corporate Insolvency Resolution Process (CIRP) must take place within 180 days of the admission of the application. A CIRP must be mandatorily completed within 330 days, including any extension or litigation period.

Initiating the CIRP

In the case of a corporate debtor, an application for insolvency proceedings must be submitted to the Adjudicating Authority (AA), which is the NCLT. The application may be filed by a financial creditor (Section 7), an operational creditor (Section 9), or the corporate debtor (Section 10) itself. Section 11 enumerates the persons not entitled to make an application, such as corporate debtor who was in a CIRP at the time of the application, or had been in one recently.

The maximum time allowed to consider the application is 14 days. If the application is allowed, the Adjudicating Authority: (i) declares a moratorium; (ii) causes a public announcement of the CIRP process and calls for the submission of claims; and (iii) appoints an Interim Resolution Professional (IRP).

Moratorium

On the date on which the insolvency commences, a moratorium is declared, and it remains in force until the end of the CIRP. The CIRP ends, either when the AA approves a resolution plan under Section 31(1), or when it passes a liquidation order under Section 33. The moratorium ensures that the CIRP has a free-rein and is the only mechanism through which claims are settled. It bars the institution of litigation against the corporate debtor, while at the same time suspending the corporate debtor's ability to move, sell, or transfer any of its assets. It bars actions both by and against the corporate debtor. However, the moratorium has certain exceptions, such as Section 14(2A), which allows the IRP to continue to supply of such goods and services as it considers necessary to preserve the value of the corporate debtor.

For the said period, the board of directors of the company stands suspended, and the promoters do not have a say in the management of the company. The IRP, if required, can seek the support of the company's management for day-to-day operations. If the CIRP fails in reviving the company, the liquidation process is initiated.

Amendments

2017 Amendment prohibits certain persons from submitting a resolution plan in case of defaults. These include: (i) wilful defaulters, (ii) promoters or management of the company if it has an outstanding non-performing debt for over a year, and (iii) disqualified directors, among others. Further, it bars the sale of property of a defaulter to such persons during liquidation.

RBI Act Chapter I,II,III

The Reserve Bank of India Act, 1934

- **CHAPTER I -** PRELIMINARY
- **CHAPTER II -** INCORPORATION, CAPITAL, MANAGEMENT AND BUSINESS
- **CHAPTER III -** CENTRAL BANKING FUNCTIONS
- **CHAPTER IIIA -**COLLECTION AND FURNISHING OF CREDIT INFORMATION
- **CHAPTER III B -** PROVISIONS RELATING TO NON-BANKING INSTITUTIONS RECEIVING DEPOSITS AND FINANCIAL INSTITUTIONS
- **CHAPTER IIIC -** PROHINITION OF ACCEPTANCE OF DEPOSITS BY UNINCORPORATED BODIES

- **CHAPTER IIID -** REGULATION OF TRANSACTIONS IN DERIVATIVES, MONEY MARKET INSTRUMENTS, SECURITIES, ETC.
- **CHAPTER IIIE -** JOINT MECHANISM
- **CHAPTER IIIF -** MONETARY POLICY

CHAPTER I - PRELIMINARY

Short title, extent and commencement.—

1. This Act may be called the Reserve Bank of India Act, 1934.
2. It extends to the whole of India
3. This section shall come into force at once, and the remaining provisions of this Act shall come into force on such date or dates6 as the Central Government may, by notification in the Gazette of India, appoint.

2. Definitions.

(a) In this Act, unless there is anything repugnant in the subject or context,—

"the Bank" means the Reserve Bank of India constituted by this Act;

"Bank for International Settlements" means by body corporate established with the said name under the law of Switzerland in pursuance of an agreement dated the 20th January, 1930,

"bank note" means a bank note issued by the Bank, whether in physical or digital form, under section 22.

(b) "the Central Board" means the Central Board of Directors of the Bank;

"Consumer Price Index" means the Consumer Price Index Combined published by the Government of India from time to time;

"Deposit Insurance Corporation" means the Deposit Insurance Corporation established under section 3 of the Deposit Insurance Corporation Act, 1961

"Exim Bank" means the Export-Import Bank of India established under the ExportImport Bank of India Act, 1981

"foreign currency" and "foreign exchange" have the meanings respectively assigned to them in the Foreign Exchange Regulation Act, 1973

(c) "Industrial Finance Corporation" means the Industrial Finance Corporation of India established under the Industrial Finance Corporation Act, 1948 (15 of 1948)

"inflation" means the year wise change in monthly Consumer Price Index expressed in terms of percentage;

"inflation target" means the inflation target determined in accordance with sub-section (1) of section 45ZA

"International Development Association" means the "Association" referred to in the International Development Association (Status, Immunities and Privileges) Act, 1960;

"International Finance Corporation" means the "Corporation" referred to in the International Finance Corporation (Status, Immunities and Privileges) Act, 1958

"International Monetary Fund" and "International Bank for Reconstruction and Development" means respectively the "International Fund" and the "International Bank", referred to in the International Monetary Fund and Bank Act, 1945;

"Monetary Policy Committee" means the Committee constituted under sub-section (1) of section 45ZB;

"National Bank" means the National Bank for Agriculture and Rural Development established under section 3 of the National Bank for Agriculture and Rural Development Act, 1981

"National Bank for Financing Infrastructure and Development" means the Institution established under section 3 of the National Bank for Financing Infrastructure and Development Act, 2021;

"other development financial institution" means a development financial institution licensed under section 29 of the National Bank for Financing Infrastructure and Development Act, 2021;

"National Housing Bank" means the National Housing Bank established under section 3 of the National Housing Bank Act, 1987

"Reconstruction Bank" means the Industrial Reconstruction Bank of India established under section 3 of the Industrial Reconstruction Bank of India Act, 1984

(d) "rupee coin" means - rupees which are legal tender, under the provisions of the Indian Coinage Act, 1906;

(e) "scheduled bank" means a bank included in the Second Schedule;

"Small Industries Bank" means the Small Industries Development Bank of India established under section 3 of the Small Industries Development Bank of India Act, 1989 (39 of 1989)

"Sponsor Bank" means a Sponsor Bank as defined in the Regional Rural Banks Act, 1976 (21 of 1976);

"State Bank" means the State Bank of India constituted under the State Bank of India Act, 1955.

(f) "State Financial Corporation" means any State Financial Corporation established under the State Financial Corporations Act, 1951

(g) “Unit Trust” means the Unit Trust of India established under section 3 of the Unit Trust of India Act, 1963

(h) “agricultural operations”, “central co-operative bank”, “co-operative society”, “crops”, “marketing of corps”, “pisciculture”, “regional rural bank” and “State co-operative bank” shall have the meanings respectively assigned to them in the National Bank for Agriculture and Rural Development Act, 1981;

(i) “co-operative bank”, “co-operative credit society”, “director”, “primary agricultural credit society”, “primary co-operative bank” and “primary credit society” shall have the meanings respectively assigned to them in Part V of the Banking Regulation Act, 1949.

CHAPTER II INCORPORATION

Capital Management And Business

Establishment and incorporation of Reserve Bank.—

A bank to be called the Reserve Bank of India shall be constituted for the purposes of taking over the management of the currency from the Central Government and of carrying on the business of banking in accordance with the provisions of this Act.

The Bank shall be a body corporate by the name of the Reserve Bank of India, having perpetual succession and a common seal, and shall by the said name sue and be sued.

Capital of the Bank.—The capital of the Bank shall be five crores of rupees.

Increase and reduction of share capital—Omitted by the Reserve Bank (Transfer to Public Ownership)Act,1948 and the Schedule (w.e.f. 1-1-1949).

Offices, branches and agencies.—The Bank shall, as soon as may be, establish offices in Bombay, Calcutta, Delhi and Madras and may establish branches or agencies in any other place in India or, with the previous sanction of the Central Government elsewhere.

Management.—

The Central Government may from time to time give such directions to the Bank as it may, after consultation with the Governor of the Bank, consider necessary in the public interest.

Subject to any such directions, the general superintendence and direction of the affairs and business of the Bank shall be entrusted to a Central Board of Directors which may exercise all powers and do all acts and things which may be exercised or done by the Bank.

Save as otherwise provided in regulations made by the Central Board, the Governor and in his absence the Deputy Governor nominated by him in his behalf, shall also have powers of general superintendence and direction of the affairs and the business of the Bank, and may exercise all powers and do all acts and things which may be exercised or done by the Bank.

Composition of the Central Board, and term of office of Directors.—

(A) The Central Board shall consist of the following Directors, namely:—

- A Governor and not more than four Deputy Governors to be appointed by the Central Government;
- four Directors to be nominated by the Central Government, one from each of the four Local Boards as constituted by section 9;
- Directors to be nominated by the Central Government; and one Government official to be nominated by the Central Government.

(B) The Governor and Deputy Governors shall devote their whole time to the affairs of the Bank, and shall receive such salaries and allowances as may be determined by the Central Board, with the approval of the 5 Central Government:

Provided that the Central Board may, if in its opinion it is necessary in the public interest so to do, permit the Governor or a Deputy Governor to undertake, at the request of the Central Government or any State Government, such part-time honorary work, whether related to the purposes of this Act or not, as is not likely to interfere with his duties as Governor or Deputy Governor, as the case may be:

further that the Central Government may, in consultation with the Bank, appoint a Deputy Governor as the Chairman of the National Bank, on such terms and conditions as that Government may specify.

(C) A Deputy Governor and the Director nominated under clause (d) of subsection (1) may attend any meeting of the Central Board and take part in its deliberations but shall not be entitled to vote:

Provided that when the Governor is, for any reason, unable to attend any such meeting, a Deputy Governor authorised by him in this behalf in writing may vote for him at that meeting.

The Governor and a Deputy Governor shall hold office for such term not exceeding five years as the Central Government may fix when appointing them, and shall be eligible for re-appointment.

A Director nominated under clause (c) of sub-section (1) shall hold office for a period of four years shall be eligible for reappointment

Provided that any such Director shall not be appointed for more than two terms, that is, for a maximum period of eight years either continuously or intermittently.

A Director nominated under clause (d) of sub-section (1) shall hold office during the pleasure of the 2 Central Government.

No act or proceeding of the Board shall be questioned on the ground merely of the existence of any vacancy in, or any defect in the constitution of, the Board.

A retiring Director shall be eligible for re-nomination.

Local Boards, Their Constitution and Functions.—

A Local Board shall be constituted for each of the four areas specified in the First Schedule and shall consist of five members to be appointed by the Central Government to represent, as far as possible, territorial and economic interests and the interests of co-operative and indigenous banks.

The members of the Local Board shall elect from amongst themselves one person to be the chairman of the Board.

Every member of a Local Board shall hold office for a term of four years and shall be eligible for reappointment: Provided that any such member shall not be appointed for more than two terms, that is, for a maximum period of eight years either continuously or intermittently

A Local Board shall advise the Central Board on such matters as may be generally or specifically referred to it and shall perform such duties as the Central Board may delegate to it.

10. Disqualifications of Directors and members of Local Boards.—

(1) No person may be a Director or a member of a Local Board who—

Is a salaried Government official, or is or at any time has been, adjudicated an insolvent, or has suspended payment or has compounded with his creditors, or is fund lunatic or becomes of unsound mind, or is an officer or employee of any bank..

(B) No two persons who are partners of the same mercantile firm, or are Directors of the same private company, or one of whom is the general agent of or holds a power of procuration from the other, or from a mercantile firm of which the other is a partner, may be Directors or members of the same Local Board at the same time.

(C) Nothing in clause (a), clause (d) or clause (e) of sub-section (1) shall apply to the Governor, or to a Deputy Governor or to the Director nominated under clause (d) of sub-section (1) of section 8.

Removal from and Vacation of Office.—

The Central Government may remove from office the Governor, or a Deputy Governor or any other Director or any member of a Local Board.

A Director nominated under clause (b) or clause (c) of sub-section(1) of section 8 shall cease to hold office if without leave from the Central Board he absents himself from three consecutive meetings of the Board convened under sub-section (1) of section 13.

The Central Government shall remove from office any Director, and the Central Board shall remove from office any member of a Local Board, if such Director or member becomes subject to any of the disqualifications specified in sub-section (1) or sub-section (2) of section 10.

A Director or member of a Local Board removed or ceasing to hold office under the foregoing sub-sections shall not be eligible for re-appointment either as Director or as member of a Local Board until the expiry of the term for which his appointment was made.

The nomination as Director or member of a Local Board of any person who is a member of Parliament or the Legislature of any State shall be void, unless within two months of the date of his nomination he ceases to be such member, and if any Director or member of a Local Board is elected or nominated as a member of Parliament or any such Legislature, he shall cease to be a

Director or member of the Local Board as from the date of such election or nomination, as the case may be.

A Director may resign his office to the Central Government, and a member of a Local Board may resign his office to the Central Board, and on the acceptance of the resignation the office shall become vacant.

Casual vacancies and absences.—(1) If the Governor or a Deputy Governor by infirmity or otherwise is rendered incapable of executing his duties or is absent on leave or otherwise in circumstances not involving the vacation of his appointment, the Central Government may, after consideration of the recommendations made by the Central Board in this behalf, appoint another person to officiate for him, and such person may, notwithstanding anything contained in clause (d) or sub-section (1) of section10, be an officer of the Bank.

Meetings of the Central Board.—

Meetings of the Central Board shall be conveyed by the Governor at least six times in each year and at least once in each quarter.

Any four Directors may require the Governor to convene a meeting of the Central Board at any time and the Governor shall forthwith convene a meeting accordingly. The Governor, or if for any reason, he is unable to attend, the Deputy Governor authorized by the Governor under the proviso to sub-section of section 8 to vote for him shall preside at meetings of the Central Board, and, in the event of an equality of votes, shall have a second or casting vote.

Business which the Bank may transact.—The Bank shall be authorised to carry on and transact the several kinds of business hereinafter specified, namely:—

the accepting of money on deposit without interest from, and the collection of money for, Central Government, State Government, local authorities, banks and any other persons:

The accepting of money as deposits, repayable with interest, from banks or any other person under the Standing Deposit Facility Scheme, as approved by the Central Board, from time to time, for the purposes of liquidity management;

the purchase, sale and rediscount of bills of exchange and promissory notes, drawn on and payable in India and arising out of bona fide commercial or trade transaction bearing two or more good signatures, one of which shall be that of a scheduled bank or a State co-operative bank or any financial institution, which is predominantly engaged in the acceptance or discounting of bills of exchange and promissory notes and which is approved by the Bank.

- in the case of bills of exchange and promissory notes arising out of any such transaction relating to the export of goods from India, within one hundred and eighty days, and
- in any other case, within ninety days,

CHAPTER III

CENTRAL BANKING FUNCTIONS

Functions of RBI

According to the RBI act 1934 RBI has various functions to serve. Some of them include:

1. **Monetary Authority:** It plans and supervises the monetary policies designed for the country. The objective behind this is that every policy should be designed keeping in mind the idea of growth and at the same time should also maintain price stability.
2. **Financial System Supervisor:** It designs the parameters under which all the banks of the country should work. The main aim here is to maintain the trust of the general public in the financial system of the country and provide them services which are cost-friendly.
3. **Foreign Exchange:** All the foreingn exchange that happens between the countries is maintained and looked after by RBI. This is done so that easy and smooth foreign trade can happen and also foreign market remains maintained.
4. **Issuer of currency:** RBI is the authority who issues notes, destroys the old notes and decides which currency is fit for circulation among the people. Demonetisation was done after taking advice from RBI and the new notes of 2000 came into circulation.
5. **Development:** various national projects are funded by RBI. It undertakes development of the country as its objective and invests at various places in national interest.
6. **Supervisory functions of RBI**

RBI also has certain supervisory functions to fulfil. They include:

- Granting licence to commercial banks
- Inspection of the other banks
- Implementing Deposit Insurance scheme
- Controlling Non-Banking financial institutions

CHAPTER IIIB

Provisions Relating to Non-Banking Institutions Receiving Deposits and Financialinstitutions

Chapter IIIB not to apply in certain cases.—The provisions of this Chapter shall not apply to the State Bank or a banking company as defined in section 5 of the Banking Regulation Act, 1949 or a corresponding new bank as defined in clause (da) of section 5 of that Act or a subsidiary bank as defined in the State Bank of India (Subsidiary Banks) Act, 1959 the Regional Rural Bank or a co-operative bank or a primary agricultural credit society or a primary credit society

Provided that for the purposes of this Chapter, the Tamil Nadu Industrial Investment Corporation Limited shall not be deemed to be a banking company.

Definitions.—In this Chapter, unless the context otherwise requires,—

"business of a non-banking financial institution" means carrying on the business of a financial institution referred to in clause (c) and includes business of a non-banking financial company referred to in clause (f)

"company" means a company as defined in section 3 of the Companies Act, 1956 (1 of 1956), and includes a foreign company within the meaning of section 591 of that Act; (b) "corporation" means a corporation incorporated by an Act of any legislature; 8

"deposit" includes and shall be deemed always to have include any receipt of money by way of deposit or loan or in any other form, but does not include,—

- amounts raised by way of share capital;
- amounts contributed as capital by partners of a firm;
- amounts received from a scheduled bank or a co-operative bank or any other banking company as defined in clause (c) of section 5 of a Banking Regulation Act, 1949

CHAPTER IIIC

PROHINITION OF ACCEPTANCE OF DEPOSITS BY UNINCORPORATED BODIES

Interpretation.—The words and expressions used in this Chapter and defined in Chapter IIIB shall have the meanings respectively assigned to them therein.

Deposits not to be accepted in certain cases.—

(1) No person, being an individual or a firm or an unincorporated association of individuals shall, accept any deposit—

i. if his or its business wholly or partly includes any of the activities specified in clause (c) of section 45-1; or
ii. if his or its principal business is that of receiving of deposits under any scheme or arrangement or in any other manner or lending in any manner

Pattern that nothing contained in this sub-section shall apply to the receipt of money by an individual by way of loan from any of his relatives or to the receipt of money by a firm by way of loan from the relative or relatives of any of the partners.

Where any person referred to in sub-section (1) holds any deposit on the 1st day of April, 1997 which is not in accordance with sub-section (1), such deposit shall be repaid by that person immediately after such deposit becomes due for repayment or within three years from the date of such commencement, whichever is earlier:

Provided that if the Bank is satisfied on an application made by any person to the Bank that such person is unable to repay a part of the deposits for reasons beyond his control or such repayment

shall cause extreme hardship to him, it may, by an order in writing, extend such period by a period not exceeding one year subject to such conditions as may be specified in the order.

on and from the date of 1st day of April, 1997, no person referred to in sub-section (1) shall issue or cause to be issued any advertisement in any form for soliciting deposit. Explanation.—For the purposes of this section, a person shall be deemed to be a relative of another if, and only if,—

i. they are members of a Hindu undivided family; or
ii. they are husband and wife; or
iii. the one is related to the other in the manner indicated in the List of Relatives below:—

List of Relatives

1. Father, 2. Mother (including step-mother),
3.Son (including stepson), 4. Son's wife,
5. Daughter (including step-daughter),
6. Father's father, 7. Father's mother,
8. Mother's mother, 9. Mother's father,
10. Son's son, 11. Son's son's wife, 12. Son's Daughter
13. Daughter's husband, 14.Son's Daughter's husband, 15. Daughter's son,
16. Daughter's son's wife, 17. Daughter's daughter, 18. Daughter's daughter's husband. 19.Brother(including step-brother), 20. Brother's wife, 21. Sister (including step-sister), 22. Sister's husband.

Power to Issue Search Warrants.—Any court having jurisdiction to issue a search warrant under the Code of Criminal Procedure, 1973, on an application by an officer of the bank or of the State Government authorised in this behalf stating his belief that certain documents relating to acceptance of deposits in contravention of the provisions of section 45S are secreted in any place within the local limits of the jurisdiction of such court, issue a warrant to search for such documents.

CHAPTER IIID

Regulation Of Transactions In Derivatives, Money Market Instruments, Securities, etc.

Definitions.—

"derivative" means an instrument, to be settled at a future date, whose value is derived from change in interest rate, foreign exchange rate, credit rating or credit index, price of securities (also called "underlying"), or a combination of more than one of them and includes interest rate swaps, forward rate agreements, foreign currency swaps, foreign currency-rupee swaps, foreign

currency options, foreign currency-rupee options or such other instruments as may be specified by the Bank from time to time;

"money market instruments" include call or notice money, term money, repo, reverse repo, certificate of deposit, commercial usance bill, commercial paper and such other debt instrument of original or initial maturity up to one year as the Bank may specify from time to time;

"repo" means an instrument for borrowing funds by selling securities with an agreement to repurchase the securities on a mutually agreed future date at an agreed price which includes interest for the funds borrowed;

"reverse repo" means an instrument for lending funds by purchasing securities with an agreement to resell the securities on a mutually agreed future date at an agreed price which includes interest for the funds lent;

"securities" means securities of the Central Government or a State Government or such securities of a local authority as may be specified in this behalf by the Central Government and, for the purposes of "repo" or "reverse repo", include corporate bonds and debentures.

CHAPTER IIIE

Joint Mechanism.—

1. Notwithstanding anything contained in this Act or the Securities and Exchange Board of India Act, 1992(15 of 1992) or any other law for the time being in force, if any difference of opinion arises as to whether—

any instrument, being derivative referred to in clause

a. money market instrument referred to in clause
b. repo referred to in clause
c. reverse repo referred to in clause
d. securities referred to in clause
e. of section 45U of this Act; or

any instrument, being policy of life insurance under the Insurance Act, 1938(4 of 1938), or the rules or regulations made there under, or, scrips or any other securities referred to in sub-clauses (i), (ia), (ib), (ic), (id), (ie), (ii), (iia) and (iii) of clause (h) of section 2 of the Securities Contracts (Regulation) Act, 1956.

Hybrid or composite instrument, having a component of money market investment or securities market instrument or a component of insurance or any other instrument referred to in clause (i) or clause (ii) and falls within the jurisdiction of the Reserve Bank of India or the Securities and Exchange Board of India established under section 3 of the Securities and Exchange Board of India Act, 1992(15 of 1992) or the Insurance Regulatory and Development Authority established

under section 3 of the Insurance Regulatory and Development Authority Act, 1999(41 of 1999) or the Pension Fund Regulatory and Development Authority constituted by the Resolution of the Government of India number F.No. 1(6)2007-PR, dated the 14th November, 2008, such difference of opinion shall be referred to a Joint Committee consisting of the following, namely:—

- **a.** The Union Finance Minister—ex officio Chairperson;
- **b.** The Governor, Reserve Bank of India—ex officio Vice-Chairperson;
- **c.** The Secretary, Department of Economic Affairs in the Ministry of Finance, Government of India—ex officio Member;
- **d.** The Secretary, Department of Financial Services in the Ministry of Finance, Government of India—ex officio Member;
- **e.** The Chairperson, Insurance Regulatory and Development Authority—ex officio Member;
- **f.** The Chairman, Securities and Exchange Board of India—ex officio Member;
- **g.** The Chairperson, Pension Fund Regulatory and Development Authority—ex officio Member.
- **h.** The Secretary, Department of Financial Services in the Ministry of Finance, Government of India shall be the convener of the meetings of the Joint Committee referred to in sub-section (1).

In case of any difference of opinion referred to in sub-section (1), any Member of the Joint Committee referred to in clauses (b), (e), (f) or (g) of that sub-section may make a reference to the Joint Committee.

The Joint Committee shall follow such procedure as it may consider expedient and give, within a period of three months from the date of reference made under sub-section (3), its decisions thereon to the Central Government.

The decision of the Joint Committee shall be binding on the Reserve Bank of India, the Securities and Exchange Board of India, the Insurance Regulatory and Development Authority and the Pension Fund Regulatory and Development Authority.

THE BANKING REGULATION ACT, 1949

The major provisions are such as Payment of Commission, Brokerage, Prohibition of Trading, Capital Structure, Non-Banking Assets, Minimum Capital and reserves, etc. Answer: The banking regulation act was passed in the year of 1949.

Introduction

No banking company shall directly or indirectly Different types of banks, such as commercial banks, cooperative banks, rural banks, and private sector banks exist in India. The Reserve Bank of India (RBI) is the governing body for regulating and supervising the banks. Banking Regulation Act, 1949 is an Act that provides a framework for regulating the banks of India. The Act came into force on 16th March 1949. This Act gives RBI the power to control the behaviour of banks. This Act was passed as Banking Companies Act, 1949. It did not apply to Jammu and Kashmir until 1956. This Act monitors the day-to-day operations of the bank. Under this Act, the RBI can licence banks, put regulation over shareholding and voting rights of shareholders, look over the appointment of the boards and management, and lay down the instructions for audits. RBI also plays a role in mergers and liquidation.

Objectives of the Banking Regulation Act, 1949

The objectives of the Banking Regulation Act are stated below:

- To meet the demand of the depositors and provide them security and guarantee.
- To provide provisions that can regulate the business of banking.
- To regulate the opening of branches and changing of locations of existing branches.
- To prescribe minimum requirements for the capital of banks.
- To balance the development of banking institutions.

Scope and applicability of the Banking Regulation Act, 1949

The sections under this Act are to be interpreted along with the sections of the Companies Act, 1956, or any other laws prevalent in the banking system. This Act applies to banking companies and cooperative banks. It will not apply to a primary agricultural credit society or a cooperative land mortgage bank, or any other co-operative society, except mentioned in Part V of the Act.

Features of the Banking Regulation Act, 1949

The Act has been divided into five parts comprising 56 sections.

The main features of the Act are mentioned below:

- Non-banking companies are forbidden to receive money deposits that are payable on demand.
- Non-banking risks are reduced by prohibiting trading by banking companies.
- Maintaining minimum capital standards.

- Regulation on the acquisition of shares of banking companies.
- Power of the Central Government to make schemes for the banks.
- Provisions regarding liquidation proceedings for banking companies.

Important Provisions of The Banking Regulation Act, 1949

Definitions

The Act has defined some terms such as banking, banking company, branch office, etc. A banking company means a company that conducts banking business in India. Banking means to accept for lending or investment of deposits of money from the public which can be repaid on demand. Subsidiary banks have the same meaning as given under the State Bank of India (Subsidiary Banks) Act, 1959. A secured loan or advance means an advance or a loan secured against the security of assets.

Business which can be Undertaken by the Banking Companies

Under Section 6(1), a banking company may be involved in the business of borrowing or lending money; buying or selling bills of exchange, promissory notes, coupons, drafts, bills of lading, railway receipts, warrants, debentures; buying or selling of foreign exchange; dealing stock, funds, shares, debentures, bonds; carrying on agency business such as clearing and forwarding of goods; conducting the business of guarantee and indemnity, etc.

Prohibition of Trading

Trading is prohibited under Section 8 of this Act. deal in the buying or selling, or bartering of goods except when it is selling the goods kept in its security. The bank should also not engage in any trade or buy, sell or barter goods except for bills of exchange received due to collection or negotiation.

Management of Bank

The bank should not employ or be employed by the managing partner as stated under Section 10 of the Act.

The bank should also not employ a person who has been adjudicated insolvent or whose remunerations depend on the profits of the company. At least 51% of the total members of the board must have professional experience in matters such as accountancy, agriculture, rural economy, banking, cooperation, economics, finance, law, small-scale industry, etc. The term of the office of the director should not be more than eight years.

Licensing of banking companies

No banking company can carry out business in India unless it has obtained a license from the RBI. RBI can hold the inspection of books before granting the license. RBI can also cancel the license if the company stops carrying on banking business in India.

Opening of new and transfer of existing branches

Every banking company must obtain the permission of RBI before opening a new branch or transferring the existing branch to a different city, town, or state. No banking company incorporated in India shall open a new branch outside India without the prior permission of RBI. However, a new branch can be opened for a temporary period not exceeding one month.

Accounts and balance-sheet

The banking companies shall prepare a balance sheet and profit and loss account on the last working day.

Inspection

RBI can cause the inspection of the banking company and must state its report to the company. The directors of the banking company must submit all books, accounts, or documents for inspection.

Power of RBI to issue directions

RBI may frequently issue directions to the banking company if it is satisfied that the directions are in the interest of the public or to prevent the banking company from detrimentally conducting business.

Restriction of certain activities by the banking company

The banking company cannot obstruct any person from entering its place of business. It cannot hold anything violent in the place of business. The banking is liable under Section 36AD for violation of the above-mentioned activities.

Amendments to the Banking Regulation Act, 1949

Banking Laws (Application To Co-operative Societies) Act, 1965

Initially, the Banking Regulation Act was passed as Banking Companies Act, 1949. But with the introduction of the Banking Laws (Application To Co-operative Societies) Act, the word Companies was omitted and the word Regulation was added to the title of the Banking Regulation Act, 1949. The Act also added a new Section called Section 56 as Part V after Part IV in the Banking Regulation Act. This section will apply to co-operative societies subjected to some modifications.

Banking Regulation (Amendment) Act, 2020 (Act 39 of 2020)

This Act came into force on September 29, 2020. The Banking Regulation Act will not be applied to a cooperative society whose main business is providing long-term financial support for agricultural development. The amendment also mentioned that the societies should not use

the words ‘bank’, ‘banker’, or ‘banking’ in their name or connection with their business. A cooperative bank may issue equity shares, preference shares, or special shares on face value or at a premium to its members or to any other person residing within its area of operation after obtaining prior approval from the Reserve Bank of India.

After the amendment, RBI may suspend the Board of Directors of a multi-cooperative bank for five years to protect the depositors. This amendment omitted some provisions like granting of unsecured loans or advances to its directors, and to private companies where the bank’s directors or chairman is an interested party, opening a new place of business, or changing the location of the cooperative bank outside of the city, town or village in which it is currently located without permission from RBI, etc.

DEPOSIT AND INSURANCE ACT

The preamble of the Deposit Insurance and Credit Guarantee Corporation Act, 1961 states that it is an Act to provide for the establishment of a Corporation for the purpose of insurance of deposits and guaranteeing of credit facilities and for other matters connected therewith or incidental thereto

Deposit Insurance and Credit Guarantee Corporation (DICGC) was launched on 15th July 1978. DICGC is one of the subsidiaries of the Reserve Bank of India. This corporation was derived by combining two corporations namely, Deposit Insurance Corporation (DIC) and Credit Guarantee Corporation of India Limited (CGCI). DICGC aims to provide insurance for deposits and to guarantee credit facilities to the customers of banks. The role of DICGC helps establish trust in the banking function amongst customers and depositors in India.

Objective of DICGC

DICGC operates to benefit the small depositors by securing the public confidence relating to the banking system by provision of deposit insurance. Hence, in case of failure of a bank, DICGC undertakes to compensate small depositors by repaying them the amount deposited in any bank.

All commercial banks including foreign, local, co-operative banks and regional banks are covered by theDeposit Insurance and Credit Guarantee Corporation (DICGC).

Features of DICGC Guarantee

- Every depositor is provided with Rs.1 lakh guarantee for both the principal and interest amount.
- If the customer has accounts in various banks, all the accounts will be insured for Rs. 1 lakh each.

- If the customer has access to more than one account in a bank, all the accounts will be considered as one account.
- The depositors or customers can avail the benefits of the deposit insurance for free of cost.
- On the other hand, the deposit insurance premium is paid by the insured banks to the DICGC.
- DICGC is endowed to cancel the registration of an insured bank if the bank does not pay the premium for three continuous half-year periods.
- DICGC can also restore the registration of a bank if the bank makes requests for restoration after payment of all overdue premiums.

Types of Deposits Covered

All bank deposits are insured by DICGC. They are saving deposits, current deposits, recurring deposits, etc.

The following deposits are not covered by this scheme.

- Deposits made by the foreign Governments
- Deposits made by the Central/State Governments
- Inter-bank deposits
- Deposits made by the State Land Development Banks with the State co-operative banks
- Any amount due and deposit received outside India
- The amount that is spared by the corporation with the previous approval of the RBI

Maintenance of Premium

It is mandatory for an insured bank to pay the premium within the last day of May and November every year. If the payment is not made within the allocated time period, an interest of 8% must be paid along with the overdue premium. The interest is calculated for the number of default days taking into account 1 year as 365 days. The premium amount can be paid in the following manner.

- It can be directly credited to the Deposit Insurance Fund account that is maintained under RBI, Deposit Accounts Department, Mumbai.
- It can be paid by crossed cheque, demand draft drawn and should be paid in Mumbai.

Maintenance of Funds

The funds that are maintained by the Corporation are as follows.

- Deposit Insurance Fund
- Credit Guarantee Fund
- General Fund

The Deposit Insurance Fund and the Credit Guarantee Fund are funded by the insurance premia and by the guarantee fee. These funds are used to compensate the respective claims. The General Fund is used for the establishment and administrative expenses of the Corporation. The balance amount from these three funds is funded to the Central Government securities. The income received from such investments are credited to the respective funds.

SARFAESI Act

"Securitization and Reconstruction of Financial Assets and Enforcement of Security Interest Act". The SARFAESI Act allows banks and other financial institutions for auctioning commercial or residential properties to recover a loan when a borrower fails to repay the loan amount.

SARFAESI Act, 2002

The SARFAESI Act full form is – "Securitization and Reconstruction of Financial Assets and Enforcement of Security Interest Act". The SARFAESI Act allows banks and other financial institutions for auctioning commercial or residential properties to recover a loan when a borrower fails to repay the loan amount. Thus, the SARFAESI Act, 2002 enables banks to reduce their Non-Performing Assets (NPAs) through recovery methods and reconstruction.

The SARFAESI Act provides that banks can seize the property of a borrower without going to court except for agricultural land. SARFAESI Act, 2002 is applicable only in the cases of secured loans where banks can enforce underlying securities such as hypothecation, mortgage, pledge etc. An order from the court is not required unless the security is invalid or fraudulent. In the case of unsecured assets, the bank would have to go to court and file a civil case against the defaulters.

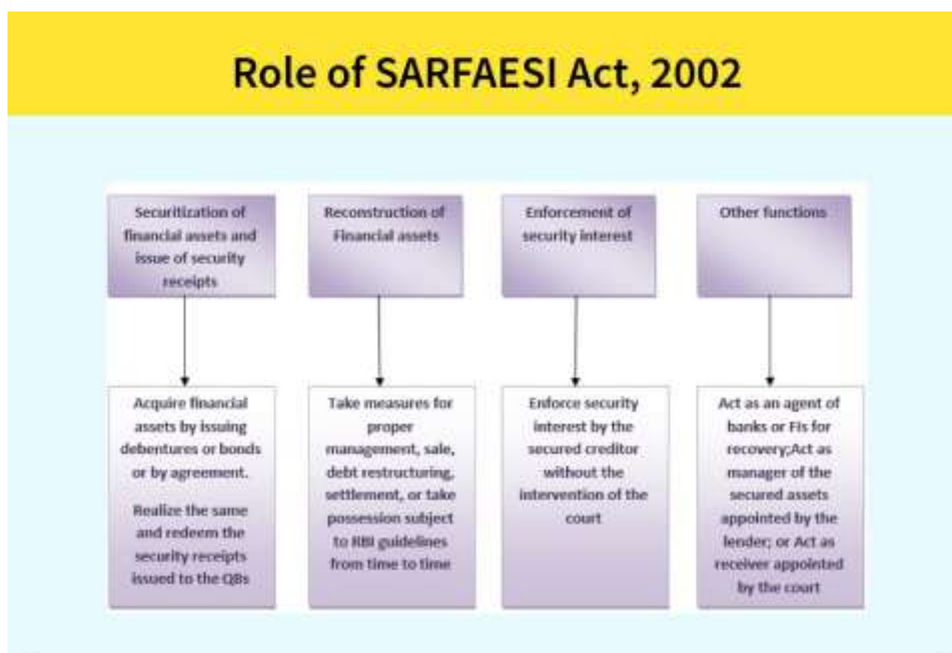
Applicability Of SARFAESI Act

The Act deals with the following:

- Registration and regulation of Asset Reconstruction Companies (ARCs) by the Reserve Bank of India.
- Facilitating securitization of financial assets of banks and financial institutions with or without the benefit of underlying securities.
- Promotion of seamless transferability of financial assets by the ARC to acquire financial assets of banks and financial institutions through the issuance of debentures or bonds or any other security as a debenture.
- Entrusting the Asset Reconstruction Companies to raise funds by issue of security receipts to qualified buyers.
- Facilitating the reconstruction of financial assets which are acquired while exercising powers of enforcement of securities or change of management or other powers which are proposed to be conferred on the banks and financial institutions.
- Presentation of any securitization company or asset reconstruction company registered with the Reserve Bank of India as a public financial institution.

- Defining ‘security interest’ to be any type of security including mortgage and change on immovable properties given for due repayment of any financial assistance given by any bank or financial institution.
- Classification of the borrower’s account as a non-performing asset in accordance with the directions given or under guidelines issued by the Reserve Bank of India from time to time.
- The officers authorized will exercise the rights of a secured creditor in this behalf in accordance with the rules made by the Central Government.
- An appeal against the action of any bank or financial institution to the concerned Debts Recovery Tribunal and a second appeal to the Appellate Debts Recovery Tribunal.
- The Central Government may set up or cause to be set up a Central Registry for the purpose of registration of transactions relating to securitization, asset reconstruction and creation of the security interest.
- Application of the proposed legislation initially to banks and financial institutions and empowerment of the Central Government to extend the application of the proposed legislation to non-banking financial companies and other entities.
- Non-application of the proposed legislation to security interests in agricultural lands, loans less than rupees one lakh and cases where eighty per cent, of the loans, is repaid by the borrower

Role of SARFAESI Act, 2002



Objectives of SARFAESI Act, 2002

Efficient or rapid recovery of non-performing assets (NPAs) of the banks and FIs.

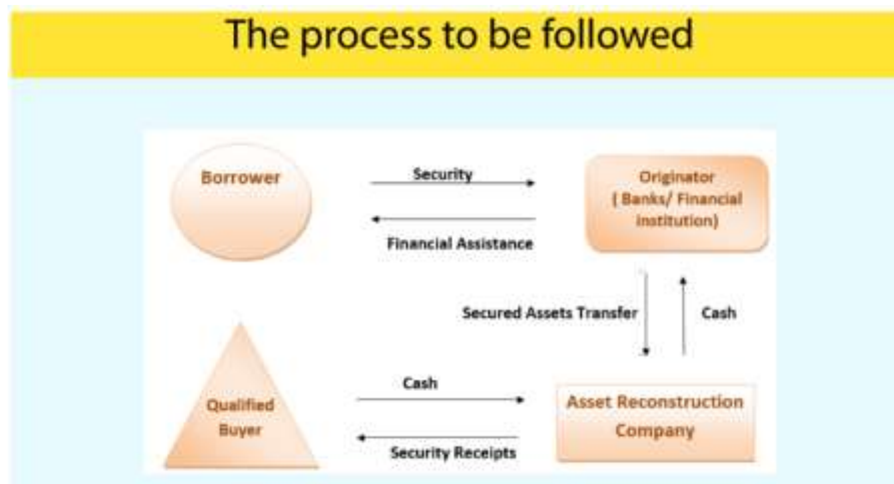
Allows banks and financial institutions to auction properties (say, commercial/residential) when the borrower fails to repay their loans.

How SARFAESI Act, 2002 works?

SARFAESI Act, 2002 provides power to a bank or financial institution to seize the property of a defaulting borrower. If the loan borrowers make any default in repayment of a loan or a loan installment, the financial institution can classify the account as Non-Performing Asset (NPA). The banks or financial institution can issue notices to the defaulting borrowers to discharge their liabilities within 60 days period. When the defaulting borrower fails to comply with the bank or financial institution notice, then the SARFAESI Act gives the following recourse to a bank:

- ➢ Take possession of the loan security
- ➢ Lease, sell or assign the right to the security
- ➢ Manage the same or appoint any person to manage the same.

The Act also provides for the establishment of ARCs, regulated by the RBI, to acquire assets from banks and other financial institutions.



Formation of SARFAESI Act, 2002

SARFAESI Act, 2002 was circulated:

- ➢ To regulate securitization and reconstruction of financial assets.
- ➢ Enforcement of the security interest for.
- ➢ Matters connected therewith or incidental thereto.

It extended to the whole of India. Amendment in the (SARFAESI) Act, 2002 vide the enforcement of the Security Interest and Recovery of Debts Laws and Miscellaneous Provisions (Amendment) Act, 2016. It is an Act to further amend four laws:

Securitization and Reconstruction of Financial Assets and Enforcement of Security Interest Act, 2002 (SARFAESI).

- ➢ Recovery of Debts due to Banks and Financial Institutions Act, 1993 (RDDBFI).

- Indian Stamp Act, 1899.
- Depositories Act, 1996, and for matters connected therewith or incidental thereto Amendments to The SARFAESI Act, 2002

The Enforcement of Security Interest and Recovery of Debts Laws (Amendment) Act, 2016 provided amendments for the SARFAESI Act, which are as follows:

The banks and Asset Reconstruction Companies (ARCs) should have the power to transfer any part of the debt of the defaulting company into equity. Such a translation would indicate that lenders or ARCs would become equity holders, instead of the creditor of the company.

Banks may request any immovable property set out for auction by themselves if they do not receive any request during the auction. In such a case, banks will be capable of adjusting the debt with the amount paid for this property. It allows the bank to secure the asset in partial fulfilment of the defaulted loan amount.

Banks can also sell this property to a new person by asking him/her to remit these debts entirely over a period of time.

Right of Borrwer Under SARFAESI Act, 2002

The borrowers have the following rights:

- Borrowers can remit the dues and avoid losing their securities before the sale is concluded.
- Borrowers will get compensation for the default of an officer.
- SARFAESI Act Section 17 provides that borrowers can approach the Debt Recovery Tribunal to rectify their grievances against the creditor or authorised officer.

Methods of Recovery Under SARFAESI Act, 2002

The SARFAESI Act provides the following three methods of recovery of the Non-Performing Assets (NPAs):

1. **Securitisation -** It is the process of issuing marketable securities backed by a pool of existing assets such as home or auto loans. An asset can be sold after it is converted into a marketable security. A securitisation or asset reconstruction company can raise funds from only the Qualified Institutional Buyers (QIBs) by forming schemes for acquiring financial assets.
2. **Asset Reconstruction** – It empowers asset reconstruction companies. It can be done by managing the borrower's business by selling or acquiring it or by rescheduling payments of debt payable by the borrower as per the provisions of the Act.
3. **Enforcement of security without the interruption of the court -** The Act empowers banks and financial institutions to issue notices to individuals who have obtained a secured asset from the borrower for paying the due amount and claim to a borrower's debtor to pay the sum due to the borrower.

Assets Not Covered Under SARFAESI Act, 2002

The SARFAESI Act does not cover the following assets:

1. Money or security issued under the Sale of Goods Act, 1930 or Indian Contract Act, 1872.
2. Any lease, hire-purchase, conditional sale, or any other contract where no security interest has been created.
3. Any rights of the unpaid seller under Section 47 of the Sale of Goods Act, 1930.
4. Any properties which are not liable for sale or attachment under Section 60 of the Code of Civil Procedure, 1908.

NON- PERFORMING ASSETS (NPA)

Loans or advances in default or arrears are called NPA or non-performing assets. Arrears is when the payments are delayed or missed. A loan defaults when the loan agreement is broken and the individual who has taken the loan cannot meet the financial obligations.

Asset and Nonperforming Assets for a Bank

Asset means anything that is owned. For banks, a loan is an asset because the interest we pay on these loans is one of the most significant sources of income for the bank.

When customers, retail or corporates, are not able to pay the interest, the asset becomes 'non-performing' for the bank because it is not earning anything for the bank. Therefore, RBI has defined NPAs as assets that stop generating income for them.

Non-Performing Assets (NPA)

NPA expands to non-performing assets (NPA). Reserve Bank of India defines Non Performing Assets in India as any advance or loan that is overdue for more than 90 days.

"An asset becomes non-performing when it ceases to generate income for the bank," said RBI in a circular form 2007.

To be more attuned to international practises, RBI implemented the 90 days overdue norm for identifying NPAs has been made applicable from the year ended March 31, 2004. Depending on how long the assets have been an NPA, there are different types of non-performing assets as well.

Types of Non Performing Assets (NPA)

Different types of non-performing assets depend on how long they remain in the NPA category.

a. **Sub-Standard Assets** - An asset is classified as a sub-standard asset if it remains as an NPA for a period less than or equal to 12 months.

b. **Doubtful Assets** - An asset is classified as a doubtful asset if it remains as an NPA for more than 12 months.

c. **Loss Assets** - An asset is considered a loss asset when it is "uncollectible" or has such little value that its continuance as a bankable asset is not suggested. However, some recovery value may be left in it as the asset has not been written off wholly or in parts.

NPA Provisioning

Keeping aside the technical definition, provisioning means an amount that the banks set aside from their profits or income in a particular quarter for non-performing assets, such as assets that may turn into losses in the future. It is a method by which banks provide for bad assets and maintain a healthy book of accounts.

Provisioning is done according to which category the asset belongs. The categories have been mentioned in the above section. Not only the type of asset but provisioning also depends on the type of bank. Like, Tier-I banks and Tier-II banks have different provisioning norms.

How Nonperforming Assets (NPA) Work?

Non-Performing Assets (NPAs) are loans or advances issued by banks or financial institutions that no longer bring in money for the lender since the borrower has failed to make payments on the principal and interest of the loan for at least 90 days.

A debt that has been past due and unpaid for a predetermined period is known as a non-performing asset (NPA).

GNPA and NNPA

Banks are required to make their NPAs numbers public and to the RBI from time to time. There are primarily two metrics that help us understand any bank's NPA situation.

NPA numbers for a bank will be mentioned in the standalone financial statements of a bank.

- GNPA: GNPA stands for gross non-performing assets. GNPA is an absolute amount. It tells you the total value of gross non-performing assets for the bank in a particular quarter or financial year, as the case may be.
- NNPA: NNPA stands for net non-performing assets. NNPA subtracts the provisions made by the bank from the gross NPA. Therefore net NPA gives you the exact value of non-performing assets after the bank has made specific provisions.

Money Laundering- Procedure, Laws and Guidelines for Anti-Money Laundering.

Money Laundering

Money laundering involves disguising financial assets so they can be used without detection of the illegal activity that produced them. Through money laundering, the criminal transforms the monetary proceeds derived from criminal activity into funds with an apparently legal source.

Money laundering is the process of illegally concealing the origin of money, obtained from illicit activities such as drug trafficking, corruption, embezzlement or gambling, by converting it into a legitimate source. It is a crime in many jurisdictions with varying definitions.

How Money Laundering Works?

Money laundering is essential for criminal organizations that wish to use illegally obtained money effectively. Dealing with large amounts of illegal cash is inefficient and dangerous. Criminals need a way to deposit money in legitimate financial institutions, yet they can only do so if it appears to come from legitimate sources.

The process of laundering money typically involves three steps: placement, layering, and integration.

- **Placement** surreptitiously injects the “dirty money” into the legitimate financial system.
- **Layering** conceals the source of the money through a series of transactions and bookkeeping tricks.
- **Integration**, the now-laundered money is withdrawn from the legitimate account to be used for whatever purposes the criminals have in mind for it.

Note that in real-life situations, this template may differ. Money laundering may not involve all three stages, or some stages could be combined or repeated several times.

There are many ways to launder money, from the simple to the very complex. One of the most common techniques is to use a legitimate, cash-based business owned by a criminal organization. For example, if the organization owns a restaurant, it might inflate the daily cash receipts to funnel illegal cash through the restaurant and into the restaurant’s bank account. After that, the funds can be withdrawn as needed. These types of businesses are often referred to as “fronts.”

When the ratio of NPAs in a bank's loan portfolio rises, its income and profitability fall, its capacity to lend falls, and the possibility of loan defaults and write-offs rise.

To address this issue, the government and the Reserve Bank of India have introduced various policies and methods to manage and reduce the amount of non-performing assets (NPAs) in the banking sector.

How to Prevent Money Laundering

Governments around the world have stepped up their efforts to combat money laundering in recent decades, with regulations that require financial institutions to put systems in place to detect and report suspicious activity. The amount of money involved is substantial. According to the United Nations Office on Drugs and Crime, global money-laundering transactions account for roughly $800 billion to $2 trillion annually, or some 2% to 5% of global gross domestic product (GDP), although it is difficult to estimate the total amount due to the clandestine nature of money laundering.3

In 1989, the Group of Seven (G-7) formed an international committee called the Financial Action Task Force (FATF) in an attempt to fight money laundering on an international scale. In the early 2000s, its purview was expanded to combating the financing of terrorism.6

The United States passed the Bank Secrecy Act in 1970, requiring financial institutions to report certain transactions, such as cash transactions above $10,000 or any others that they deem suspicious, on a suspicious activity report (SAR) to the Department of the Treasury.14 The information that the banks provide to the Treasury Department is used by the Financial Crimes Enforcement Network (FinCEN), which can share it with domestic criminal investigators, international bodies, or foreign financial intelligence units.7

While these laws were helpful in tracking criminal activity, money laundering itself wasn't made illegal in the United States until 1986, with the passage of the Money Laundering Control Act.8 Shortly after the Sept. 11, 2001, terrorist attacks, the USA Patriot Act expanded money-laundering efforts by allowing investigative tools designed for the prevention of organized crime and drug trafficking to be used in terrorist investigations.1

The Association of Certified Anti-Money Laundering Specialists (ACAMS) offers a professional designation known as a Certified Anti-Money Laundering Specialist (CAMS). Individuals who earn CAMS certification may work as brokerage compliance managers, Bank Secrecy Act officers, financial intelligence unit managers, surveillance analysts, and financial crimes investigative analysts.

Anti-Money Laundering (AML) in Simple Words -

In the most general sense, Anti-Money Laundering (AML) refers to the collection of laws, processes, and regulations that prevent illegally obtained money from entering the financial system.

AML targets a wide variety of crimes, from corruption and tax fraud to market manipulation and illicit trade, as well as efforts to mask these activities as the source of money.

Because most criminals and terrorists rely significantly on laundered money for their illegal operations, having effective AML procedures in place has broader crime-reducing consequences.

Many businesses must do extensive customer due diligence under Money Laundering Regulations to prevent money laundering and economic crime. AML checks are an essential aspect of customer due diligence since they screen clients against PEP and Sanctions lists and verify their claimed identities. Failure to comply with AML standards can result in financial penalties and, in extreme cases, disqualification as a business/director.

Who is Using Anti-Money Laundering (AML)?

Financial institutions are the most prominent users of AML legislation, as they are compelled to report any suspicious behavior to authorities. However, financial institutions are not only obligated to report suspicious behavior. Still, they are also at a higher risk of money laundering since they provide credit to consumers who open accounts with the company.

History of Anti-Money Laundering

The Bank Secrecy Act (BSA), adopted by the United States in 1970, was one of the first pieces of anti-money laundering legislation. The BSA, an early attempt to identify and prevent money laundering, has been updated and strengthened by new anti-money laundering regulations. The Financial Crimes Enforcement Network (FinCEN) is currently the BSA's authorized administrator, with the aim of "protecting the financial system from financial crime abuses such as terrorist financing, money laundering, and other illicit activity."

The Global Financial Action Task Force (FATF) was established in 1989 by a group of governments and organizations. Its mission is to create and promote worldwide money-laundering prevention standards. FATF expanded its scope to encompass AML and terrorism funding shortly after the 9/11 attacks on the United States. Another major body is the International Monetary Fund (IMF). Its primary goal, with 189 member countries, is to preserve the stability of the international monetary system. The IMF is concerned about the impact money laundering and similar crimes can have on the financial sector's and the broader economy's integrity and stability.

The European Union also released the first anti-money laundering Directive in 1990 to prevent the financial system's misuse of money laundering. The European Union AML Directives are constantly being revised to reduce the risks associated with money laundering and terrorist financing.

AML Regulations

When developing procedures for detecting money laundering activities within their scope, obligated entities (a list of which may be found here) are held to high standards. To comply with primary AML national and international legislation, they must build a complete AML framework that includes the following measures:

- Mechanisms for screening transactions and software filters;
- Strong Know Your Consumers (KYC) methods to verify, identify and check customers or businesses against sanctions and watch lists;
- Identification of ultimate beneficiaries for legal companies through due diligence and enhanced due diligence based on the level of assessed risk;
- Demonstrate that the business took every effort to avoid money laundering-related actions.
- Preserve all documentation pertaining to the identification of its clients and transactions.

Compliance with AML legislation for "chosen obligated entities" posing a high risk will be monitored in the near future by the forthcoming European entity AMLA EU (Anti-Money Laundering Authority of the European Union). As a result, a stronger emphasis on such institutions may significantly influence their requirement for AML compliance.

AML standards vary by country, but in general, financial institutions take the following steps to ensure compliance:

Know Your Customer (KYC)

To maintain authenticity, financial institutions must need sufficient client identity and verification. Higher-risk goods and services necessitate more detailed documentation.

Reporting on Large Money Transactions

Institutions are required to file a regulatory report (known as a "CTR" in the United States) for transactions over a specific threshold made by a single client during a business day.

Monitoring and Reporting of Suspicious Actions

Regulatory bodies issue AML guidelines outlining the types of activity that should be monitored (e.g., making numerous cash deposits or withdrawals over several days to avoid a reporting threshold). If an AML investigator discovers behavior that exceeds reporting criteria and has no obvious business purpose, they must submit a SAR/STR with the FIU in order to meet regulatory obligations.

Compliance With Sanctions

Financial institutions are required by regulatory bodies such as the US Treasury Department, the US Office of Foreign Assets Control, the United Nations, the European Union, Her Majesty's Treasury, and the Financial Action Task Force on Money Laundering to check transaction parties against lists of sanctioned individuals, companies, institutions, and countries.

Unit II

Operational Aspect of Commercial Banks in India

Commercial banks are institutions that accept deposits from the general public and generate profits that give money (loans) to individuals such as homes, entrepreneurs, and business people. The bank, as an agency, pays on behalf of the customer and receives fees for the agency function.

The nation's financial institution system is dominated by the nation's government banks, which number twenty at the present time. Commercial banks are institutions that operate for the purpose of making a profit. They are those institutions that accept deposits from the general public and give money (loans) to individuals such as households, entrepreneurs, businessmen, and others. Profitability in the form of interest, commission, and other forms is the primary focus of these financial institutions. The Reserve Bank of India, which is India's central bank as well as the country's highest financial authority, is in charge of overseeing and controlling how all of these commercial banks conduct their business.

The Following are the Primary Responsibilities of Commercial Banks

- Deposit Acceptance
- Being in the business of providing credit for shorter terms, commercial banks are happy to take the public's savings in the form of the following deposits:
- Fixed Term deposits
- Current A/c deposits
- Deposits made on a regular basis
- Saving A/c deposits
- Tax saving deposits

Deposits for Non-Resident Indians Money Lending: A second primary function is to extend credit in the form of loans and advances and to collect interest on that credit. This function is the primary contributor to the income that the banks bring in.

The term "overdraft facility" refers to the authorization given to a current account holder to withdraw an amount that is greater than the amount that he or she has deposited in their account.

Loans and advances are both secured and unsecured forms of credit that are taken out against some form of collateral. Bill of exchange discounting entails presenting the bill of exchange to the appropriate commercial bank in order to have it discounted in the event that the bearer of the bill requires immediate access to funds.

Credit in Expenses:

It is a service that allows one to withdraw a predetermined sum of money from a particular security.

Commercial banks also perform the following secondary functions:

Agency functions: As an agent, the bank makes payments on behalf of its customers, and in exchange, the bank receives a fee for performing agency functions such as the following:

Taxes and bills must be paid.

- Bills, checks, and other forms of payment are used in the collection of funds.
- Transfer of funds- transaction involving the purchase and sale of shares and debentures
- The accrual and distribution of dividends or interest
- Trustees and executors of the properties they oversee
- Transactions involving foreign exchange
- Locker facility is part of the General Utility Services.

The Establishment of Credit: It is regarded as one of the most essential tasks performed by commercial banks. Credit is generated by a bank on the basis of the primary deposits it receives. After that, it loans the money to standard borrowers, corporations, and investors. People who have extra money and who want to earn a consistent return on that money deposit it in landed money because they know they will get it back. When it comes to interest rates, commercial banks typically charge their customers, also known as borrowers, a higher percentage than they offer to those who deposit money with the bank.

RELATIONSHIP BETWEEN BANKER AND CUSTOMERS

The relationship between a banker and a customer depends on the type of transaction. In this banker and customer relationship, both parties have some obligations and rights. The relationship between banker and customer is not only that of a debtor and creditor. However, they also share other relationships.

The banker and customer relationship are based on trust. This relationship is divided into two important parts to understand clearly:

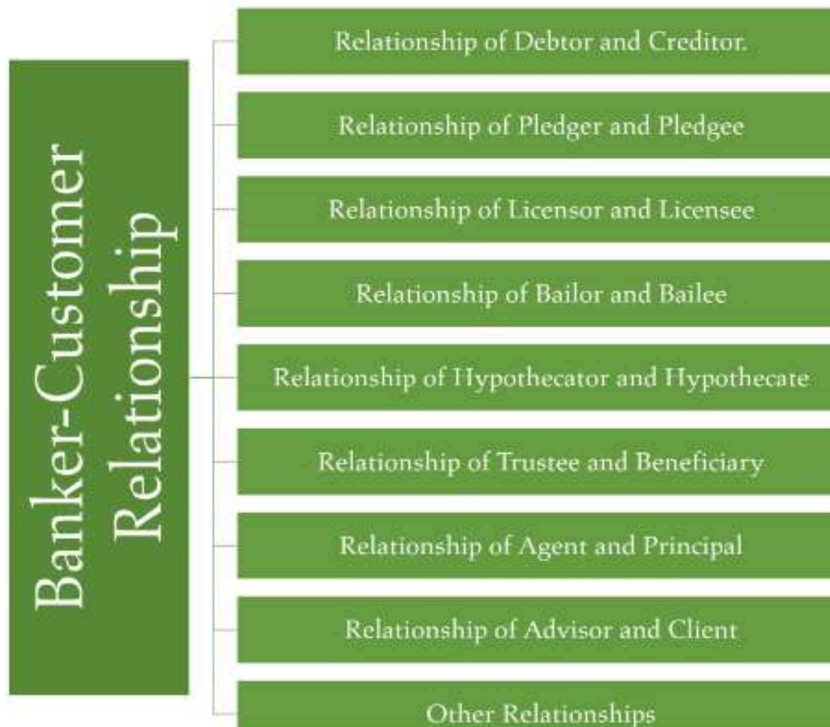
The Special Relationship Between Banker and Customer

The services provided by a banker to its customer come under a general relationship between banker and customer

The General Relationships between Banker and Customer are

1. Relationship as Debtor and Creditor
2. Relationship as Trustee and Beneficiary
3. Relationship as principal and Agent
4. Relationship as Lesser and Lessee

5. Relationship as Pledger and Pledgee
6. Relationship as Bailor and Bailee
7. Relationship as Advisor and Client



8. Relationship as Mortgagor and Mortgagee
9. Relationship as Indemnity holder and Indemnifier
10. Relationship as Hypothecator and Hypothecatee

Other/Special Relationship between Banker and Customer

1. Maintain records
2. Maintain Confidentiality
3. Obligation to Honour Cheques

1. **Relationship as Debtor and Creditor** The opening of a bank account in the bank of a banker by a person who has the capacity to contract is the basis of the debtor and creditor relationship between banker and customer. By filling out the form for opening a bank account bind the banker and customer in the written contract. The customer when deposits his money into his bank account, becomes a creditor because he is giving his money to the bank indirectly. The money deposited by the customer in the bank account becomes the bank's property. The bank can use your money as it likes. By using your money, the bank becomes a debtor because he will take that money into his account to make further transactions with other bank customers. The bank is not liable to inform the customer about the utilization of his money.

2. **Relationship as Trustee and Beneficiary** The bank performs the relationship as a trustee with his customer when the bank customer deposits his property or other assets. In this case, the bank holds the property of other documents of bank customers in exchange for the loan provided by the bank. The person who is depositing the property or other documents is known as the beneficiary.

It can be done in two conditions:

- When a person deposits his important document in the bank locker.
- The person took the loan and deposited his property document as security.

3. **Relationship as principal and Agent** The bankers provide agent services to their customers. The agent is defined under section 182 of the Indian Contract Act as the agent is the person who is employed by a person by giving him the power of attorney to work or deal on his behalf. The banker pay taxes, electricity bills, insurance premium etc. at the command of the bank customer who acts as principal. The bank usually charges for these services provided by the bank to its customers.

   In the banking industry, the relationship between a banker and a customer can be considered as a principal-agent relationship. In this type of relationship, the customer (the principal) entrusts the bank or the banker (the agent) with their money and other financial assets, and the bank or the banker acts on the customer's behalf to manage and invest those assets.

   The customer, as the principal, is the party who has the ultimate control over their assets and makes the final decisions on how they should be managed. The bank or the banker, as the agent, is the party who is responsible for executing the customer's instructions and managing their assets in accordance with the customer's wishes.

   The bank or the banker has a fiduciary duty to act in the best interests of the customer and to use reasonable care, skill, and diligence in managing the customer's assets. This means that the bank or the banker must always act in the customer's best interests, even if it is not in the best interests of the bank or the banker. The bank or the banker must not use their position of trust and confidence to gain any advantage over the customer or to benefit themselves at the customer's expense.

4. **Relationship as Lesser and Lessee** Section 105 of the Transfer of property act deals with the **contract of lease.** It is a transfer of a right to enjoy the immovable property for a certain time with consideration**.** This happens in the relationship between banker and customer when the bank provides a safe deposit locker to the customer of the bank to save his important property for a certain period of time. The bank changes its customer who is taking the benefit of the locker for a certain period of time.

The relationship between a banker and a customer can also be understood in terms of a lesser and lessee relationship. In this context, the customer is the lessee and the bank is the lesser.

In a lease agreement, the lessee (customer) is granted the use of an asset (such as a piece of property or equipment) by the lesser (the bank), usually in exchange for rent or a periodic payment. Similarly, when a customer opens an account with a bank, they are essentially leasing the use of the bank's assets, such as its capital and liquidity, in order to access financial services such as borrowing, depositing, and investing.

5. **Relationship as Pledger and Pledgee** The banker performs the relationship of Pledger and Pledgee when the customer took the loan from the bank and deposits some security to the banker. The customer becomes a pledger and the bank is pledgee. The security of the customer will remain in the custody of the bank until the person repays the money from the loan taken by him from the bank.

The relationship between a banker and a customer can also be understood as a pledgee and a pledger. In this context, a pledge is a legal agreement in which a borrower (the pledger) gives the lender (the pledgee) the right to take possession of and sell the specific property (the collateral) if the borrower defaults on the loan. This type of arrangement is commonly used in secured lending, where the borrower is required to provide collateral in order to secure the loan.

In a banking context, the customer may pledge assets such as real estate, vehicles, or stocks as collateral for a loan or line of credit. The bank, as the pledgee, holds the right to take possession of and sell the pledged assets in the event that the customer defaults on the loan. This allows the bank to recover its losses if the borrower is unable to repay the loan.

6. **Relationship as Bailor and Bailee** The banker can perform the relationship of bailor and bailee with its customer. There are many types of bailment under which the person delivers his goods to another party for a specific period of time and takes the goods back when the purpose of bailment has been done.

   The relationship of bailor and bailee between banker and customer arises when the customer gives his security document of any other goods to the bank for a specific period of time for security. The customer is a bailor and the bank becomes bailee.

7. **Relationship as Advisor and Client** The relationship between banker and customer can be as advisor and client in a case when the customer invests in securities. The bank gives advice to its customer for investing. For example, if you are planning to take any kind of loan, but are not sure which loan you should take. Here, the bank can advise you officially or unofficially to make the right decision. In that case, the banker will be your advisor and you will be his client.

8. **Relationship as Mortgagor and Mortgagee** Section 58(a) of the Transfer of Property Act, of 1882 defines the mortgage as "A mortgage is the transfer of an interest in specific immovable property for the purpose of securing the payment of money advanced by way of loan, etc."

   When the banker provides the credit facility to his customer against the security of immovable property, the customer becomes a mortgagor and the bank is a mortgagee.

9. **Relationship as Indemnity holder and Indemnifier** There are various types of indemnity given under the Indian Contract Act. Indemnity is one of the types of contract in which one person promises to save another party by paying his loss that occurred due to the person who is making the contract or by the act of any other person.

   In the relationship between banker and customer, the banker acts as an indemnity holder if any wrong transaction is done while making the payment by the customer.

   For example, if you make an online transaction with another person but the transaction fails and your money is deducted. The bank will repay the loss that occurred due to fault occurred in the transaction.

10. **Relationship as Hypothecator and Hypothecatee** The relationship between banker and customer converts into Hypothecator and Hypothecatee when the bank customer hypothecates some movable or immovable property or any other assets into the bank to take the loan from the bank. In this case, the bank customer is a hypothecator and the banker is Hypothecatee.

Special Relationship between Banker and Customer

The duties and instruction to the banker come under a special Relationship between Banker and Customer.

1. **Maintain records** It is the duty of the banker to maintain every record of the transaction, loan and investment done by the bank customer. These records must be clear, genuine and authorized. The bank customer has the right to check his transaction details whenever he needs them. In a case where the transaction details are needed, the bank has the duty to provide the true details to its customer with the stamp and signature of the authorized person. Any mistake in the records can bring the bank into trouble.

2. **Maintain Confidentiality** A banker is responsible for the safety of the documents, records or any other property which is deposited by the bank customer in the bank. The information must remain confidential. However, there are some conditions when the banker can disclose these confidential documents saved in the bank account.

3. **Obligation to Honour Cheques** The bank is responsible for accepting the Cheque of the customer that is equivalent to the amount present in the account. There are some necessary conditions which must be fulfilled by the Cheque. Lack of these conditions can lead to the dishonour of cheques. Some important conditions are:
   - Proper format of the Cheque
   - Correctly signed by the person
   - Properly presented in the bank
   - There must be an available balance in the bank account.

Termination of Relationship between the Banker & the Customer

The relationship between a banker and a customer can come to an end for a variety of reasons. Some of the most common reasons for the termination of this relationship include:

1. **Liquidation of the company** -The banker and customer relationship can be terminated at the time of:
   - Liquidation of bank
   - Winding up of a company**.**
2. **Death or lunacy of a customer -** If the bank customer dies and becomes a lunatic, the banker and customer relationship will terminate.
3. **Completion of contrac**t
4. **The loan taken by the bank customer is repaid**
5. **The bank guarantee has been completed**
6. **Closing the account after bank notice -** It is the right of the banker that if he finds any illegal activity with the account or any other reasonable ground, the bank can close the account after giving proper notice to the customer.
7. **Voluntary Closure of Account -** Customers may choose to close their accounts with a bank for a variety of reasons, such as moving to a different area, dissatisfaction with the bank's services, or finding a better deal elsewhere. Banks are typically obligated to close a customer's account if requested to do so, but they may require the customer to provide proper identification and settle any outstanding debts or fees.
8. **Involuntary Closure of Account -** Banks may choose to close a customer's account if they suspect fraud or illegal activity, if the customer has violated the terms of their account agreement, or if the customer has not maintained the minimum balance required by the bank. Banks may also close accounts that have been inactive for a certain period of time. Customers should be notified of the bank's decision to close their account and given an explanation for the closure.

9. **Termination by the Bank due to Risk Assessment -** Banks may terminate customer relationships in case of higher risk assessment for a customer for instance when the customer is involved in money laundering activities, financing terrorism, other illegal activities, violation of anti-bribery laws, sanctions or other laws, regulations, rules and guidance. Also, if the customer's information provided is inaccurate, false or incomplete, a relationship may be terminated.
10. **Non-compliance with KYC or AML regulations** Banks are required to comply with various regulations related to the identification and verification of their customers, as well as to monitor their transactions for any suspicious activity. Failure to comply with these regulations may result in the termination of the customer's account and possible legal consequences for the bank.
11. **Bankruptcy or Insolvency of the Customer -** If a customer declares bankruptcy or becomes insolvent, their accounts may be frozen and their assets may be used to pay off their debts. Banks may also be required to write off any outstanding loans or debts owed by the customer.
12. **Merger or Acquisition of the Bank -** If a bank is acquired by another bank, or if two banks merge, the accounts of the customers of the acquired or merged bank may be transferred to the acquiring or surviving bank. In such cases, customers may be given the option to close their accounts or to continue banking with the acquiring or surviving bank.

It's worth noting that, termination of a customer relationship can be initiated by either party, the customer or the bank. The termination process should follow a formal process and adequate notice should be given to the other party. The bank should also have a protocol to handle the customer's funds and assets after the termination of the relationship.

When a bank terminates a customer relationship, it may have an impact on the customer's credit score, and it can also limit the customer's access to banking services and financial products. Therefore, customers should be aware of the reasons why their accounts may be closed, and they should take steps to ensure that they are in compliance with all of the bank's terms and conditions to avoid any potential problems.

TYPES OF CUSTOMER ACCOUNT

Banks operating in India fall under four categories: private banks, public sector banks or nationalized banks, foreign banks and cooperative banks. All four of these categories of banks allow citizens to open a bank account in India.

1. **Savings Account -** These are deposit accounts meant to help consumers save their money. A savings account can be opened by any individual in India who holds an Aadhaar card and a PAN card, both of which are mandatory to open a bank account in India.

Key Features of a Savings Account

- **Limit** There is no limit to the amount of money that can be saved in a savings account. The number of transactions may be capped in some cases, depending on your bank.
- **Balance -** A consumer is expected to maintain a mandatory minimum balance in most cases to maintain a savings account.

2. **Pradhan Mantri 2. Jan Dhan Yojana (PMJDY)** - Under PMJDY, one savings account with zero balance is opened per person. These accounts fall under the Basic Savings Bank Deposit Accounts, which limit the number and value of deposits that can be made, and withdrawals are capped at four per month, including ATM withdrawals.

Key Features of a PMJDY Account

- **Interest -** A consumer earns interest on the deposits made in a savings account. This interest rate varies from one bank to another. For example, interest rate for savings bank deposit is 2.70% for account balance of up to INR 1 lakh at India's largest public sector bank, State Bank of India. While, interest rate for savings bank deposit is 3% for account balance below INR 50 lakh at India's largest private sector bank, HDFC Bank.
- **Benefit -** Savings accounts serve as the easiest way to earn interest on idle money lying in banks.

3. **Current Account -** Current accounts are mostly business accounts where money is frequently transferred between financial accounts. These accounts are best suited for transactions by corporations and business owners for daily business activities.

Key Features of a Current Account

- **Limit -** There is no limit to how much money can be put in a current account. Current accounts also do not have a transaction limit.
- **Balance -** A current account has a higher minimum balance requirement than savings accounts.
- **Interest -** Consumers do not earn any interest on current accounts.
- **Benefit -** These accounts allow an overdraft facility, which permits consumers to withdraw more money from the account that there is actually in the account.

4. **Salary Account -** These accounts are opened by banks upon the request of big corporations and businesses that pay their employees through banks. Each employee is eligible to maintain a salary account in which the company they are employed with credits a monthly salary.

Key Features of a Salary Account

- **Limit -** There is no limit to how much money can be put in a salary account. Each employee receives salaries based on disbursal from their employees. Independent transactions can be made by employees to transact between this kind of bank account with another.
- **Balance -** A salary account is a zero balance account and employees can withdraw all the money credited in the account at any point.
- **Interest -** Employees do not earn any interest on salary accounts.
- **Benefit -** These accounts can be converted into savings accounts at any point in time. Upon inactivity for more than three months, banks hold the rights to convert these accounts into savings accounts, the regulation for which is different.

NRI Account

These accounts are opened by non-resident Indians who wish to maintain a financial bank account in India. There are three kinds of NRI accounts that can be opened:

5. **Non-Residential Ordinary Account (NRO) -** These accounts hold deposits in Indian rupee denomination. The money deposited is from proceeds earned in India.

   Key Features of an NRO

   - **Limit -** There is no limit to how much money can be put in an NRO account.
   - **Balance -** Any amount of balance can be maintained.
   - **Interest -** The principal and the interest earned on that principal fall under the taxable category.
   - **Benefit -** These accounts are unaffected by the rate of conversion. An NRI can open a current account, a savings account or a fixed deposit account via the NRO account.

6. **Non-Residential External Account (NRE) -** These accounts hold deposits in Indian rupee denomination. The money deposited, however, is not from proceeds earned in India; in other words, the money deposited is earnings or savings from the country where the non-resident Indian lives.

   Key Features of an NRE

   - **Limit -** There is no limit to how much money can be put in an NRE account.
   - **Balance -** Any amount of balance can be maintained.
   - **Interest -** The principal and the interest earned on that principal do not fall under the taxable category.
   - **Benefit -** These accounts bear the impact of a prospective change in the rate of conversion. An NRI can open a current account, a savings account or a fixed deposit account via the NRE account.

7. **Foreign Currency Non-Residential Account (FCNR) -** These accounts hold deposits in the currency approved by the central bank of India, the Reserve Bank of India. Any NRI or a person of Indian origin can hold deposits in an approved currency in which they earn their income. If the

income is earned in a currency other than the approved list of currencies, then an approved currency is chosen for the conversion of the earnings or the proceeds to be deposited. FCNR accounts are often called FCNR (B) accounts where the (B) stands for banks.

Key Features of an FCNR

- **Limit -** There is no limit to how much money can be put in an FCNR account.
- **Balance -** Any amount of balance can be maintained.
- **Interest -** The principal and the interest earned on that principal do not fall under the taxable category.
- **Benefit -** These accounts bear the impact of a prospective change in the rate of conversion. An NRI can open only a fixed deposit account with a minimum maturity of one year via the FCNR account.

8. **Recurring Deposit (RD) Accounts -** These accounts are opened as deposit accounts by consumers who are interested in earning interest on their money. Commonly known as RDs, these accounts are the easiest ways to earn an income higher than that offered by savings accounts.

Key Features of a Recurring Deposit

- **Limit -** The minimum limit to open an RD differs from one bank to another. Consumers can opt for a minimum limit as low as INR 1,000 per month and open an RD account with any bank of their choice.
- **Balance -** RDs are deposit accounts that allow consumers to collect a monthly amount set at the beginning of the tenure of the account.
- **Interest -** A fixed amount is deducted every month and collected in the RD account, where it earns interest month-on-month. This interest is often higher than savings accounts.
- **Benefit -** The flexible tenure of the RD makes it a consumer-friendly financial decision. Consumers can opt for anywhere from six months to up to 10 years to deposit their money in an RD and earn interest on the deposited amount. RD accounts can be discontinued before the end of the tenure without losing the interest earned.

9. **. Fixed Deposit (FD) Accounts -** These accounts are opened to earn interest on deposits for a fixed period of time until maturity. Fixed deposits are among the safest financial instruments to save and earn interest on idle money.

Key Features of a Fixed Deposit

- **Limit -** There is no limit to how much money can be put in a fixed deposit account. The higher the money allocation, the more interest is paid at the end of the account's tenure.
- **Balance -** An FD account holds a lump sum amount as investment.

- **Interest -** The bank pays an interest on this deposit. This interest is paid once the tenure of the FD is complete. Upon breaking the FD in the middle of its tenure, consumers risk losing out on the interest and often receive only the principal amount.
- **Benefit -** FDs are risk-free investments with high returns. Most banks in India offer an FD interest rate higher than savings accounts' interest rates and RDs' interest rates, owing to the fixed tenure benefit a bank enjoys in the case of FDs. Banks can hold big sums for a fixed period and consumers can make higher volatility-free returns, turning the financial instrument into a win-win for banks and consumers.

CHEQUE & ITS TYPES, ENDORSEMENT, DISHONOUR

Cheque

In this article, we shall discuss in detail what is a cheque, various types of cheques that are issued in the Indian banking system and what are the features of each of them. Aspirants can check the linked article for the latest government exams in India.

A cheque is a piece of document/paper which orders the bank to transfer money from the bank account of an individual or an organisation to another bank account.

The person who writes the cheque is called the "**drawer**" and the person in whose name the cheque has been issued is called the "**payee**". The amount of money that needs to be transferred, payee's name, date and signature of the drawer are all mentioned in a cheque.

There are certain points to remember regarding cheques which are mentioned below:

1. A cheque can only be issued against a current or savings bank account
2. A cheque without date shall be considered invalid
3. Only the payee, in whose name the cheque has been issued, can encash it
4. A cheque is only valid 3 months from the date it has been issued
5. A 9-digit MICR (Magnetic Ink Character Recognition) code is mentioned at the bottom of the cheque. This makes the clearance of cheques easier for the banks.

Further below each type of cheque has been discussed in detail for candidates to study and prepare themselves for the upcoming Government exams.

The Various Types Cheque :

1. Bearer Cheque
2. Crossed Cheque
3. Account Payee Cheque
4. Stale Cheque
5. Post Dated Cheque
6. Ante Dated Cheque

7. Self Cheque
8. Traveler's Cheque
9. Mutilated Cheque
10. Blank Cheque

1. **Bearer Cheque** - The bearer cheque is a type of cheque in which the bearer is authorised to get the cheque enchased. This means the person who carries the cheque to the bank has the authority to ask the bank for encashment.

   This type of cheque can be used for cash withdrawal. This kind of cheque is endorsable. No kind of identification is required for the bearer of the cheque.

   For example: A cheque has been signed by Arjun (drawer) and the payee for the cheque is Varun. Varun can either go to the bank himself or can send a third person to get encashment for the cheque. No identification shall be required for the bearer's name.

2. **Order Cheque** - This type of cheque cannot be endorsed, i.e., only the payee, whose name has been mentioned in the cheque is liable to get cash for that amount. The drawer needs to strike the "OR BEARER" mark as mentioned on the cheque so that the cheque can only be encashed to the payee.

   For Example: If a cheque has been signed with the name of Varun, then only the payee can visit the bank to get an encashment for the same for a order cheque.

3. **Crossed Cheque -** In this type of cheque, no cash withdrawal can be done. The amount can only be transferred from the drawer's account to the payee's account. Any third party can visit the bank to submit the cheque. In case of a crossed cheque, the drawer must draw two lines at the left top corner of the cheque.

4. **Account Payee Cheque -** This is the same as the account payee cheque but no third party involvement is required. The amount shall be transferred directly to the payee's account number.

   To ensure that it is an account payee cheque, two lines are made on the left top corner of the cheque, labelling it for "A/C PAYEE".

5. **Stale Cheque -** In India, any cheque is valid only until 3 months from the date of issue. So if a payee moves to the bank to get withdrawal for a cheque which was signed 3 months ago, the cheque shall be declared a stale cheque.

   For example: If a cheque is dated January 1, 2021, and the payee visits the bank for withdrawal on May 1, 2021, his/her request shall be denied and the cheque is declared stale.

6. **Post Dated Cheque** - If a drawer wants the payee to apply for withdrawal or transfer of money after the present date, then he/she can fill a post dated cheque.

For example: If the date on which the drawer is filling the cheque is May 10, 2021, but he wants the payment to be done later, he/she can fill the cheque dates as May 30, 2021. It shall be called a post-dated cheque.

7. **Ante Dated Cheque -** If the drawer mentions a date prior to the current date on the cheque, it is called ante dated cheque.

   For example: If the current date is January 30, 2021, and the drawer dates the cheque as January 1, 2021. It shall be considered as an ante-dated cheque.

8. **Self Cheque -** If the drawer wishes cash for himself he can issue a cheque where in place of the Payee's name he can write "SELF" and get encashment from the branch where he owns an account.

   For example: If a person wants Rs.1,00,000/- in cash, he can issue a self cheque and visit his bank branch where he owns an account and get encashment in place of a cheque.

9. **Traveller's Cheque -** As the name suggests, the Traveler's cheque can be used when a person is travelling abroad where the Indian currency is not used.

   If a person is travelling abroad, he can carry the traveller's cheque and get encashment for the same in abroad countries.

10. **Mutilated Cheque -** If a cheque reaches the bank in a torn condition, it is called a mutilated cheque. If the cheque is torn into two or more pieces and the relevant information is torn, the bank shall reject the cheque and declare it invalid, until the drawer confirms its validation.

    If the cheque is torn from the corners and all the important data on the cheque is intact, then the bank may process the cheque further.

11. **Blank Cheque -** When a cheque only has a drawer's signature and all the other fields are left empty, then such a type of a cheque is called a blank cheque.

    The above-mentioned types of cheques are the most commonly known and used in the Indian banking industry. Let us now know the parties associated with a cheque.

Number of Parties involved with a Cheque

There are three parties involved with a cheque.

1. **Drawer or Maker –** Drawer of the cheque is the customer or account holder who issues the cheque.
2. **Drawee –** Drawee is basically the bank on which the cheque is drawn. Remember that a cheque is always drawn on a particular banker.
3. **Payee –** This is the person who is named in the cheque and gets the payment for the amount mentioned in the cheque. In particular cases (when the drawer writes a self-cheque), the drawer and the payee can be the same individual.

Apart from these three, there are two more parties involved with a cheque –

1. **Endorser:** When a party i.e. payee transfers his right to take the payment to another party, he/she is called endorser.
2. **Endorsee:** The party in whose favour, the right is transferred, is called endorsee.

Essentials of a Cheque

There are certain extremely important pointers or features of a cheque which should be known and understood before using this payment mode for money transfer. Some of the important pointers related to a cheque are:

- A cheque is an unconditional order.
- A cheque's payment is always in cash.
- A cheque is always drawn on a particular Bank.
- A cheque is always payable on demand.
- Signature on the exchequer is mandatory and should be only by the maker.
- The amount is always a certain sum of money from one's account.
- This cash amount is to be paid to the person mentioned therein, or order, or the bearer.

Aspirants must know that any direct or indirect question may be asked from this topic in the general awareness section and they must be completely prepared for the same.

Endorsement

Endorsement meaning refers to placing a signature or an equivalent stamp on any negotiable instrument to authorize its transfer to another party. Individuals may put their signature on an instrument to restrict payment, incur the endorser's liability, or negotiate it.

That said, one must note that this term's meaning may not be the same. It can also refer to an amendment made to a document or contract, for example, an insurance endorsement. Moreover, it also refers to a public statement of support for a service, product, or person.

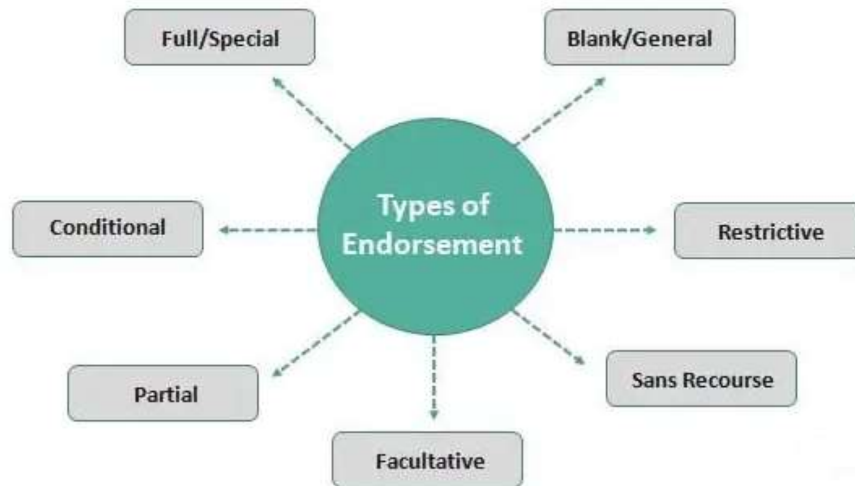
Suppose two parties are negotiating order paper and not bearer paper. In that case, the individual to whom it is payable must make sure to endorse the instrument before transferring it to another party. The endorsement may change the order paper to bearer paper and vice versa. Moreover, it may restrict the rights of any subsequent holder.

Types of Endorsement

Besides knowing endorsement meaning, you must be aware of its different types.

Blank/General - In this case, the endorser places only their signature on the negotiable instrument and does not write the name of a party who will receive the payment.

Figure: Types of Endorsement



Restrictive - This limits the principal features of an instrument and restricts its further negotiability. Endorsers have the right to prohibit the subsequent transfer of an instrument. It prevents the risk of the drawer losing their money owing to fraud or forgery.

Sans Recourse - This type of endorsement relieves the endorser from all the liability against subsequent holders of the negotiable instrument.

Facultative - Here, the endorser gives up some right to which they have entitlement. For instance, endorsees are responsible for giving notice of dishonor to the endorser. In case they fail to provide this notice, the latter will be free from their liability.

Partial - This arrangement allows the transfer of only a portion of the amount payable on an instrument to the endorsed.

Conditional - In this case, the endorser places their signature under such writing, which makes their liability due thereon depending upon the occurrence of a particular event.

Full/Special - The act is special or full when an endorser or transferor signs the instrument and writes the payee's name too. As a result, the latter becomes entitled to sue for the amount payable on the instrument.

CHEQUE DISHONOUR

A cheque falls under the dishonoured category when a payee cannot successfully deposit the payer's cheque. A payer is the one who issues a cheque to the payee. The payee deposits this cheque in the bank. If the bank refuses to pay the amount mentioned on the cheque, the cheque is dishonoured.

In usual terms, the non-payment of a cheque for any cause is called a 'cheque bounce' or 'dishonour of cheque'. There can be two main grounds for the dishonour of a cheque .i.e.

1. A technical failure in the cheque (such as a mismatch of signs, a huge difference between the amount written in words and in figures, etc.) or

2. Funds in the account of the drawer are insufficient.

Kinds Of Dishonour Of Cheque

a. **Dishonour By Non-Acceptance -** Section 19 of the Act talks about the dishonour by non-acceptance. Presentment for acceptance is needed only in the case of a bill of exchange. Generally, acceptance and payment go together and this commonly happens in case an instrument is payable after sight, thus it is often difficult to differentiate the two because dishonour by non-payment is commonly dishonoured by non-acceptance, so it is only this bill of exchange which can be dishonoured by non-acceptance and not a cheque as in the case of a cheque, no acceptance is needed to be taken to the banker and cheques are primarily instruments payable at sight.

b. **Dishonour By Non Payment -** Dishonour by non-payment is the second type of dishonour. A negotiable instrument is assumed to be dishonoured by non-payment when the drawee of a cheque makes default in payment upon being duly required to pay the same. If the drawer of the cheques issues directions to the bank for not making any payment of a specific cheque issued by him, then the bank stands revoked from making payment on that particular cheque, this is called as countermand of cheques by the drawer.

Reasons for Dishonour of Cheque

i. Closed Account
ii. Funds not sufficient
iii. Mismatched signatures
iv. Account holder stopped the payment
v. Customer's Death
vi. Customer's Insanity
vii. The disparity in the figures and words mentioned in the cheque

Legal Framework

Legislation on the dishonour of cheque is referred from section 138 to 142 of the Negotiable Instruments Act 1881 as amended by Negotiable Instruments (Amendment) Act 2015. The penal provisions provided in Sections 138 to 142 of the Act have been made to ensure that obligations undertaken by providing cheques as a method of deferred payment are honoured. Section 138 of the Act requires for the conditions under which a suit for the dishonour of cheques is filed. The essential ingredients which are necessary for complying with Section 138 are the following:

1. A person must have drawn a cheque for payment of money to another for the discharge of any debt or other liability;

2. That cheque is returned by the bank unpaid, either because insufficient of funds or that it exceeds the amount arranged to be paid from that account by an agreement made with the bank;
3. The payee makes a demand for the payment of the money by giving a notice in writing to the drawer within 15 days of the receipt of information by him from the bank regarding the return of the cheque as unpaid;
4. The drawer fails to make a payment to the payee within 15 days of the receipt of the notice.

Punishment

An individual who commits an offence under Section 138 may be punished as under :

1. Imprisonment for up to 2 years.
2. A fine which may extend to twice the amount of the cheque, or with both.

However, no person can be punished unless the cheque has been presented to the bank within 3 months from the date on which it is drawn or within the period of its validity, whichever is earlier.

RIGHTS AND LIABILITIES OF PAYING AND COLLECTING BANKER

Paying and Collecting Banker: Difference

The paying banker gets protection under the Negotiable Instrument Act section 85, and the collecting banker gets protection under section 131. If a banker plays both roles at the same time, then the banker can be called a collecting banker but not liable as a paying banker.

Paying banker and collecting banker can be defined as follows

"The bank on which a cheque is drawn (the bank whose name is printed on the cheque) and which pays the amount for which the cheque is written and deducts that sum from the customer's account." The paying banker should use due care and diligence in paying a cheque so as to refrain from any action potential enough to damage his customer's credit.

"A Collecting banker is the one who attempts to collect different types of instruments representing money in favour of his customer or his own behalf from the drawers of these instruments; some are negotiable instruments as provided for in the Negotiable Instruments Act, 1881."

Rights and Liabilities of Paying and Collecting Banker

Rights and liabilities of a both types of bankers can be discussed as follows:

Rights of Paying and Collecting Banker

The rights of the banker include:

1. **Right of General Lien:** can be retained till the owner discharges the debt or obligation to the possessor. A lien is the right of a creditor in possession of goods, securities or any other

assets belonging to the debtor to retain them until the debt is repaid, provided that there is no contract express or implied, to the contrary. A banker has the right to retain the property belonging to the customer until the debt due from him has been paid. It is a right to retain possession of specific goods or securities or other movables of which the ownership vests in some other person and the possession

2. **Right to set off:** The right of set off is also known as the right of combination of accounts. Right to set off is a right of the banker to adjust his outstanding Joan (debit) in the name of the customer from his credit balance of any of the accounts he s maintaining with the bank. A bank has a right to set off a debt owing to a customer against a debt due from him. Right to set off is nothing but combine the two or more accounts of a customer of the customer. If the customer have two or more account and in case of absence of agreement the banker can exercise has right of set off:
   - **a.** The two or more accounts must be in the name of same customer
   - **b.** There must be same capacity
   - **c.** There must be same bank ,though different branches
   - **d.** One account should show debit balance and other should show a credit balance
   - **e.** The debt must be manual
   - **f.** The amount of debit should be certain one
3. **Right to close an account:** There should be no confusion between closing the account and stopping operation of the account. The contractual relationship between banker and customer is terminated by closing the account. There is no opportunity for the customer to operate the account once again. On the other hand, stopping operation of an account refers to the suspension of the operation of an account for the time being, at the advent of certain events. It is purely suspension of the relationship between a banker and a customer and the customer can operate the account, after such events come to a close.

The circumstances for closure of account are:

(a) Customer’s intension to close the account

- i. The customer can close the account in any of the following condition
- ii. If he does not agree to the terms of the banker such as rate of interest, bank charges etc
- iii. If the customer does not enjoy such facilities as are offered by some other banks e.g. free transfer of money up to Rs.10000
- iv. When the confidence of the person is shaken.

(b) Bankers intention to close the account Notes

- i. The banker can close the account of the customer when he finds

ii. The account is not remunerative

iii. When the customer is not a desirable one.

(c) Customer's death-as soon as the bank gets notice of the death of the customer, he should immediately stop the operations of the account. It is because death puts an end to the contract.

(d) Customers insanity-the banker should stop the operation of his account .the banker should apply for the official copy of Lunacy Order.

(e) Customers insolvency-when the banker comes to know that the customer is insolvent than the bank will close the account of the customer.

4. **Right to appropriate payments:** The banker has the right to appropriate the money deposited by a customer to any one of the loan account due by him. The appropriation arises when the customer has more than one account one showing the debit balance and the other with a credit balance. The customer is given the first option to decide the account to which the amount should be credited. If the customer fails to indicate his choice then the banker has every legal right to credit the amount in any one account of that customer.

Liabilities of Paying Bankers

Following are the liabilities of paying bankers:

- Checking the signature of the drawer.
- Verification of the genuineness of the instrument.
- Payment not stopped by the A/c holder
- Holder's title on the cheque is valid.
- A/c is not dormant one.
- A/c holder is not bankrupt or deceased.
- A/c is not under subject of liquidation process.
- No 'Garnishee Order' is issued by court.
- Properly endorsed.
- Cheque is not drawn beyond limit fixed by the drawer is respect of amount.
- Instrument being presented is crossed.
- Instrument is not state or postdated.
- No material adjustment is made.
- Sufficient balance in the A/c

Liabilities of Collecting Bankers

Following are the liabilities of collecting bankers:

1. **Acting as agent:** While collecting an instrument, the Bankers works as agent of his customer. As an agent he has to take some steps & precautions to protect the interest or his customer as a man of ordinary discretion would take to safeguard his own interest.
2. Scrutinizing the instruments: Name of the holder, Branch name, amount in world and figure, date, material alteration of any to be checked carefully.
3. Checking the endorsement: Bankers have to check the instrument whether it has been endorsed properly.
4. Presenting the instrument in due time: It is the responsibility of the collecting bank to present the instrument in due time to the paying bank.
5. Collecting the proceeds in the payee's account: It is the duty of collecting banks to collect and credit the proceeds of the instruments to the proper/correct account.
6. Notice of dishonour and returning the instruments: If any instrument is dishonoured by the paying bank it should be informed to the customer on the day following the receipt of the unpaid instruments.

TIME VALUE OF MONEY

The time value of money means that a sum of money is worth more now than the same sum of money in the future. The principle of the time value of money means that it can grow only through investing so a delayed investment is a lost opportunity.

Time Value of Money (TVM)

Investors prefer to receive money today rather than the same amount of money in the future because a sum of money, once invested, grows over time. For example, money deposited into a savings account earns interest. Over time, the interest is added to the principal, earning more interest. That's the power of compounding interest.

If it is not invested, the value of the money erodes over time. If you hide Rs.1,000 in a mattress for three years, you will lose the additional money it could have earned over that time if invested. It will have even less buying power when you retrieve it because inflation reduces its value.

As another example, say you have the option of receiving Rs.10,000 now or Rs.10,000 two years from now. Despite the equal face value, Rs.10,000 today has more value and utility than it will two years from now due to the opportunity costs associated with the delay. In other words, a delayed payment is a missed opportunity.

The time value of money has a negative relationship with inflation. Remember that inflation is an increase in the prices of goods and services. As such, the value of a single dollar goes down when prices rise, which means you can't purchase as much as you were able to in the past.

Time Value of Money Formula

The most fundamental formula for the time value of money takes into account the following: the future value of money, the present value of money, the interest rate, the number of compounding periods per year, and the number of years.

Based on these variables, the formula for TVM is:

$$FV = PV(1 + i/100)^n$$

where:

FV = Future value of money

PV = Present value of money

i = Interest rate

n = Number of years

Present Value

The **Present Value (PV)** is an estimation of how much a future cash flow (or stream of cash flows) is worth right now. All future cash flows must be discounted to the present using an appropriate rate that reflects the expected rate of return (and risk profile) because of the "time value of money."

How to Calculate Present Value (PV)?

The present value (PV) concept is fundamental to corporate finance and valuation.

The premise of the present value theory is based on the "time value of money", which states that a dollar today is worth more than a dollar received in the future.

Therefore, receiving cash today is preferable (and more valuable) than receiving the same amount at some point in the future.

There are two primary reasons that support this theory:

Opportunity Cost of Capital: If the cash is currently in your possession, those funds could be invested into other projects to earn a higher return over time.

1. **Inflation**: Another risk to consider is the effects of inflation, which can erode the actual return on an investment (and thereby future cash flows lose value due to uncertainty).

Future Value

The present value (PV) formula discounts the future value (FV) of a cash flow received in the future to the estimated amount it would be worth today given its specific risk profile.

The formula used to calculate the present value (PV) divides the future value of a future cash flow by one plus the discount rate raised to the number of periods, as shown below.

$$FV= PR/(1+r)^{n}/100$$

Where:

FV = Future Value

PR = Present Value

r = Rate of Return

n = Number of Periods

Keep in mind, though that the TVM formula may change slightly depending on the situation. For example, in the case of annuity or perpetuity payments, the generalized formula has additional or fewer factors.

Unit- III

NEGOTIABLE INSTRUMENTS Act 1881

A negotiable instrument is a signed document that promises a payment to a specified person or assignee. Negotiable instruments are transferable, which allows the recipient to take the funds as cash, then use them as preferred. Examples of negotiable instruments include checks, money orders, and promissory notes.

The word negotiable' means "transferable by delivery" and instrument means "a written document by which a right is created in favor of some person or persons. Thus, the term negotiable instrument literally means a written document which creates a right in favor of somebody and is freely transferable.

A negotiable instrument is a piece of paper which entitles a person to a certain sum of money and which is transferable from one to another person by a delivery or by endorsement and delivery.

E.g. - Promissory note, Cheque and a Bill of exchange, documents such as Railway or ST Receipts; Dividend, warrants; Railway Bonds payable etc

Characteristics of Negotiable of Instruments

Freely transferable: The property in a negotiable, instrument passes from one person to another by a simple process, i.e., by mere delivery if it is payable to bearer, and by endorsement and delivery if it is payable to order.

Holder's title free from all defects: The holder in due course (one who acquires the instrument in good faith and for consideration) gets it free from all defects.

Presumptions Negotiable of Instruments

Consideration: It shall be presumed that every negotiable instrument was} made, drawn, accepted or endorsed for consideration. It is also presumed that, consideration is present in every negotiable instrument until the contrary is proved. The presumption of consideration however may be rebutted by proof that the instrument had been obtained from its lawful owner by means of fraud or undue influence.

Presumption as to Date: Where a negotiable instrument is dated, the} presumption is that it has been made or drawn on such date, unless the contrary is proved.

Time of acceptance: Unless the contrary is proved, every accepted bill of exchange is presumed to have been accepted within a reasonable time after its issue and before its maturity. This presumption only applies when the acceptance is not dated; if the acceptance bears a date, it will prima facie be taken as evidence of the date on which it was made.

Time of transfer: Unless the contrary is proved, it shall be presumed that every transfer of a negotiable instrument was made before its maturity. But it is also seen that there is no presumption as to the exact date of negotiation.

Order of endorsement: Until the contrary is proved, it shall be presumed that the endorsements appearing upon a negotiable instrument were made in the order in which they appear thereon. For example, in a situation where no evidence is adduced by the defendant, and when the instrument is signed by the second defendant below the endorsement signature of first defendant (who is the payee in the promissory note), the presumption will be made that the endorsement signatures were made in the order in which they occur, according to Section. 118.

Stamp: Unless the contrary is proved, it shall be presumed that a lost promissory note, bill of exchange or cheque was duly stamped

The Concept of Negotiability The concept of negotiability is one of the most important features of commercial paper. A negotiable instrument is basically a piece of paper that can be transferred multiple times from one person/entity to another without the use of actual cash. It signifies or

replaces money. A common example of a negotiable instrument is a check that can be endorsed multiple times by different parties. Each time it is endorsed and given to another, it represents payment to that party. Because of this feature, negotiable instruments are highly trusted and are used daily by millions of people. A negotiable instrument is a written document, signed by the maker or drawer, containing an unconditional promise to pay, or order to pay, a certain sum of money on delivery or at a definite time to the bearer, or to the order of. It can be transferred from party to party and accepted as a substitute for money. It is important to know whether an instrument is negotiable.

1. Be in writing.
2. Be signed by the maker or the drawer.
3. Be an unconditional promise or order to pay.
4. State a specific sum of money.
5. Be payable on demand or at a definite time.
6. Be payable to order or to bearer.

1. **Written Document** Negotiable instruments must possess the quality of certainty that only formal written expression can give, but the requirement is somewhat flexible in how it can be satisfied. The writing may be done in pen, printing, typewriting or pencil as long as it is legible. . The surface on which the writing is executed must be capable of being circulated. The fact that an instrument is in writing means that the parol evidence rule governs the admissibility of oral evidence to contradict the terms of the instrument. Parol evidence is a substantive rule of contracts under which a court will not receive into evidence prior oral statements that contradict a written agreement if the court finds that the written agreement was intended by the parties to be a final, complete and unambiguous expression of their agreement.
2. **Signed by the Maker or Drawer** This second requirement is relatively straightforward: The actual or authorized signature of the issuer is required for the instrument to be negotiable. The maker is the person or company who makes or executes a note. A note is an instrument containing an express and absolute promise of signer or maker to pay to a specified person, order or bearer a definite sum of money at a specified time. The drawer is the person or company who makes or executes a draft. A draft is a written order by the first party, called the drawer, instructing a second party, called the drawee (such as a bank), to pay money to a third party, called a payee. Oral evidence is admissible to identify the signer of an instrument. For example, there are typically several people bearing a common name—such as John

Smith. The appropriate person is allowed to testify as to which John Smith was the actual maker of the note.

3. **Unconditional Promise to Pay** The unconditional promise to pay requirement maintains that the promise or order to pay contained in the commercial paper must not be conditional on the occurrence or nonoccurrence of some other event or agreement. Requiring that something be done, or that a specific event occur before an instrument can be collected on, reduces the instrument to the status of a simple contract whose rights, at best, can merely be assigned.
4. **A Sum Certain in Money** One requirement of a sum certain is that the amount must be clearly ascertainable from the face of the instrument. To qualify the instrument as negotiable, the sum certain must be calculable at two distinct times: at purchase and at maturity. When the holder considers buying the instrument, the exact minimum amount payable on it must be calculable from the information on its face. At maturity, the holder must be able to calculate from the face the exact amount due. For instance, a demand note payable with 10% interest meets the requirement of a sum certain because its amount can be determined at the time it is payable.
5. **On Demand or at a Definite Time** To satisfy this requirement, the time the instrument is payable must be determined in one of two ways. On demand is synonymous with "at presentment" or "at sight" meaning that the holder has the option of choosing the time to receive payment. Equally acceptable is specifying the time when the instrument matures. Such expressions as "due and payable 60 days from March 3, 20__," "due and payable 60 days from sight," or "due and payable on or before March 3, 20__" are all acceptable. The holder must be able to determine from the face of the instrument the latest possible time it can be paid without default.
6. **Payable to Order or Bearer** The last requirement is the most straightforward: An order or bearer instrument must be "payable to the order of the named payee(s)," "payable to the named payee's order" or some equivalent wording. A bearer instrument must be written "pay to bearer," "pay to cash," "pay to the order of the bearer," "pay to the order of the named payee(s) or bearer" or the like. Finally, if an instrument is made out to an obviously fictitious person, such as Superman, it is treated as a bearer instrument.

Eight Requirements for Negotiable Instruments

1. **Must be in writing**.
   - A writing can be on anything that is readily transferable.
2. **Must be signed by the instrument**
   - The signature can be any place on the instrument.

- It can be in any form (such as word, mark or stamp) that purports to be a signature and authenticates the writing.
- It can be signed in a representative capacity

3. **Must be a definite order or promise to pay.**
   - A promise must be more than a mere acknowledgement of a debt. • The words "I/We Promise" or "Pay" meet this criterion.
4. **Must be unconditional**.
   - Payment cannot be expressly conditional upon the occurrence of an event.
   - Payment cannot be made subject to or governed by another agreement.
   - Payment cannot be paid out of a particular fund (except for a government issued instrument).
5. **order Must be an or promise to pay a sum certain**.
   - An instrument may state a sum certain even if payable in installments, with interest, at a stated discount or at an exchange rate.
   - Inclusion of cost of collection and attorney's fees does not disqualify the statement of a sum certain.
6. **Must be payable in money**.
   - Any medium of exchange recognized as the currency of a government is money.
   - The maker or drawer cannot retain the option to pay the instrument in money or something else.
7. **Must be payable on demand or at a definite time**.
   - Any instrument payable on sight, presentation or issue is a demand instrument.
   - An instrument is payable at a definite time even though it is payable on a stated date, or within a fixed period after sight, or the drawer or maker has an option to extend time for a definite period.
   - Acceleration clauses, even if unenforceable, do not affect the negotiability of the instrument.
8. **Must be payable to order or bearer**.
   - An order instrument must name the payee with reasonable certainty.
   - An instrument whose terms intend payment to no particular person is payable to bearer.

KINDS OF NEGOTIABLE INSTRUMENTS

To some extent, commercial law is a reflection of customs and usages of trade in the business world. The development of the law concerning commercial paper—checks, promissory notes and

the like—grew from commercial necessity. which serve as a substitute for money and as a credit device:

1.Drafts.

2.Cheque.

3.Notes.

4.Certificates of deposit.

1. **Drafts** A draft, also known as a bill of exchange, is an instrument that orders someone else to pay. The order is given by the drawer, who issues the draft usually by signing it in the lower right-hand corner. The one who is ordered to pay the money is called the drawee. The one who is to receive the money is known as the payee. Drafts may be presented to the drawee for payment or for acceptance. When a draft is presented for acceptance, the drawee is asked to become liable on the instrument.
2. **Cheque** A cheque is a draft on which the drawee is a bank that is ordered to pay on demand; it is the most common form of a draft. It is drawn on a bank by a drawer, who has an account with the bank, to the order of a specified person or business named on the check, or to the bearer. Ownership of a check may be transferred to another person by the endorsement of the payee. In this manner, a check may circulate among several parties, taking the place of money. Banks provide regular and special printed check forms. These check forms display a series of numbers printed in magnetic ink, known as the MICR line, which makes it possible to process checks electronically and accurately. Among the information found on a MICR line is the check number (usually located to the far left). If the magnetic numbers do not match the printed numbers at the upper right, the check is likely fraudulent and should not be accepted. The use of printed forms is not required. Any writing, no matter how crude, may be used as a check if it is a draft drawn on a bank and payable on demand.
2. **Notes** A note, or promissory note, is a written promise by one party, called the maker, to pay money to the order of another party, called the payee. In contrast with drafts, notes are promise instruments rather than order instruments, and they involve only two parties instead of three. They are used by people who loan money or extend credit as evidence of debt. When two or more parties sign a note, they are called co-makers.
    - **Demand Notes** A demand note, as its name implies, is payable whenever the payee demands payment. A time note is payable at some future time, on a definite date named in the instrument. Unless a note is payable in installments, the principal (face value) of the note plus interest must be paid on the date that it is due. In an installment note, the

principal, together with interest on the unpaid balance, is payable in installments at specified times.

- **Promissory Notes** Promissory notes come in the following forms:
  - Single-name paper is a note signed by only one maker. No one else is liable on it.
  - Double-name paper is a promissory note signed by two or more makers or signed by the maker and endorsed by others. With additional people standing behind the note, the likelihood of payment is increased.

4.Certificates of Deposit A certificate of deposit (CD) is an acknowledgment by a bank of the receipt of money and its promise to pay the money back on the due date, usually with interest. Certificates of deposit generally pay more interest than regular savings accounts because the depositor cannot withdraw the money before the due date without penalty. Their negotiability allows them to be sold, to be used to pay debts or to serve as security or collateral for a loan or credit agreement.

PROMISSORY NOTES

A promissory note is a written and signed promise to repay a sum of money in exchange for a loan or other financing. A promissory note typically contains all the terms involved, such as the principal debt amount, interest rate, maturity date, payment schedule, the date and place of issuance, and the issuer's signature.

Although financial institutions may issue them—for instance, you might be required to sign a promissory note to take out a small personal loan—promissory notes also allow companies and individuals to get financing from a non-bank source. This source can be an individual or a company willing to carry the note (and provide the financing) under the agreed-upon terms. In effect, promissory notes can enable anyone to be a lender.

Promissory notes come in the following forms:

- Single-name paper is a note signed by only one maker. No one else is liable on it.
- Double-name paper is a promissory note signed by two or more makers or signed by the maker and endorsed by others. With additional people standing behind the note, the likelihood of payment is increased.

A Brief History of Promissory Notes

Promissory notes have had an interesting history. At times, they have circulated as a form of alternate currency, free of government control. In some places, the official currency is in fact a form of promissory note called a demand note (one with no stated maturity date or fixed term, allowing the lender to decide when to demand payment).

Promissory notes and bills of exchange are governed by the 1930 Geneva Convention of Uniform Law on Bills of Exchange and Promissory Notes.2 Its rules also stipulate that the term "promissory note" should be inserted in the instrument's body and contain an unconditional promise to pay.

In the United States, promissory notes are often used in when getting a mortgage, student loan, or a loan from a friend or family member. They're also sometimes issued to corporate clients.

How Promissory Notes Work Promissory notes can lie between an IOU's informality and a loan contract's rigidity. An IOU merely acknowledges a debt and the amount one party owes another. A promissory note includes a promise to pay on demand or at a specified future date, and steps required for repayment (like the repayment schedule).

In its simplest form, a promissory note might be a written promise to repay a family member. State or federal securities entities may regulate more complicated promissory notes.

Secured vs. Unsecured Promissory Notes

A promissory note can be secured or unsecured. A secured promissory note describes the collateral—typically property—that secures the debt or amount borrowed. For example, if the borrower owns property, the lender can use the car as collateral until the debt is repaid. If the borrower doesn't repay the loan, the lender can take possession of the property.1

An unsecured promissory note doesn't involve collateral. In this case, if the borrower doesn't repay the loan, the lender can try to use standard debt-collection procedures.

In either case, the lender holds the promissory note until the debt is repaid. Typically, those drafting a promissory note will consult with an attorney to make sure the note follows any state or federal laws around loans or investments.

Types of **Promissory Notes**

- **Personal Promissory Notes** – This is a particular loan taken from} family or friends. Though people avoid legal writings when seeking a loan from close contact, the promissory note shows belief and trust in the interest of the borrower.
- **Commercial –** Here, the note is made when dealing with commercial} lenders such as banks. Most of the commercial promissory agreement is similar to personal notes.
- **Real Estate –** This is similar to commercial notes in terms of} nonpayment consequences. If the borrower becomes a defaulter, then the party has the right to keep the property until the debt is cleared. It is a little risky as all the essential details become public, which can hinder the borrower’s credit history in the future.

- **Investments** – The promissory note is occasionally used to raise funds} for the business. It is used as a security purpose and managed by securities laws. It includes terms and conditions related to returns of investment.
- **Collateral Notes** A collateral note is a note that is secured by certain collateral, such as stocks, bonds, personal property or mortgages. Its outstanding feature is that the collateral is held by the creditor while the note is outstanding. Such a note may be negotiated in the same manner as any negotiable note, whether the collateral is assigned or not.

Parties Involve in Promissory Notes

- **Drawer:** A drawer is a person who agrees to pay the drawee a certain amount of money on the maturity of the promissory note. He/she is also known as maker.
- **Drawee:** She/he is an individual, in whose favour the note is prepared. In usual cases the drawee is also the payee until and unless the promissory note is transferred specifically in favour of the payee. For e.g. Ram is considered a drawer if he promises to pay Shyam Rs.5000 (Shyam is the drawee). However, if the same promissory note is transferred in favour of Rohan, then Rohan becomes the payee.
- **Payee:** A payee is someone to whom the payment is made.

Features of Promissory Notes

- **Printed/Written Agreement** – A promissory should be in writing, and an oral promise to pay money is not accepted.
- **Pay Defined Amount** – It is a promise to pay the money on a particular time or when demanded. The mentioned amount can neither be added or subtracted.
- **Signed Documents** – The document is duly signed and drawn by the} drawer and stamped. **Unconditional Promise** – The promise to pay a certain amount of money must be absolute in all cases. In such notes, a conditional guarantee is not accepted.
- **Legal Composition** – All the payment should be made in the nation's legal currency.
- **Detailed Information** – The note has all the required information} including the name of the drawer and payee, date of maturity, terms of repayment, issue date, name of the drawee, name, and signature of the drawer, principal amount, and the rate of interest, etc.

BILLS OF EXCHANGE

A bill of exchange is a written order used primarily in international trade that binds one party to pay a fixed sum of money to another party on demand or at a predetermined date. Bills of exchange are similar to checks and promissory notes—they can be drawn by individuals or banks and are generally transferable by endorsements.

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

A bill of exchange transaction can involve up to three parties. The drawee is the party that pays the sum specified by the bill of exchange. The payee is the one who receives that sum. The drawer is the party that obliges the drawee to pay the payee. The drawer and the payee are the same entity unless the drawer transfers the bill of exchange to a third-party payee.

Unlike a check, however, a bill of exchange is a written document outlining a debtor's indebtedness to a creditor. It's frequently used in international trade to pay for goods or services. While a bill of exchange is not a contract itself, the involved parties can use it to fulfill the terms of a contract. It can specify that payment is due on demand or at a specified future date. It's often extended with credit terms, such as 90 days. As well, a bill of exchange must be accepted by the drawee to be valid.

Bills of exchange generally do not pay interest, making them in essence post-dated checks. They may accrue interest if not paid by a certain date, however, in which case the rate must be specified on the instrument. They can, conversely, be transferred at a discount before the date specified for payment. A bill of exchange must clearly detail the amount of money, the date, and the parties involved including the drawer and drawee.

Example

Say Company ABC purchases auto parts from Car Supply XYZ for Rs.25,000. Car Supply XYZ draws a bill of exchange, becoming the drawer and payee in this case. The bill of exchange stipulates that Company ABC will pay Car Supply XYZ Rs.25,000 in 90 days. Company ABC becomes the drawee and accepts the bill of exchange and the goods are shipped. In 90 days, Car Supply XYZ will present the bill of exchange to Company ABC for payment. The bill of exchange was an acknowledgment created by Car Supply XYZ, which was also the creditor in this case, to show the indebtedness of Company ABC, the debtor.

Differences Between a Bill of Exchange and a Cheque

A check always involves a bank while a bill of exchange can involve anyone, including a bank. Cheque are payable on demand while a bill of exchange can specify that payment is due on demand or at a specified future date. Bills of exchange generally do not pay interest, making them in essence post-dated checks. They may accrue interest if not paid by a certain date, but that rate must be specified on the instrument. Unlike a check, a bill of exchange is a written document outlining a debtor's indebtedness to a creditor.

Types of Bills of Exchange

A bill of exchange issued by a bank is referred to as a bank draft. The issuing bank guarantees payment on the transaction. A bill of exchange issued by individuals is referred to as a trade draft. If the funds are to be paid immediately or on-demand, the bill of exchange is known as a sight draft. In international trade, a sight draft allows an exporter to hold title to the exported goods until the importer takes delivery and immediately pays for them. However, if the funds are to be paid at a set date in the future, it is known as a time draft which gives the importer a short amount of time to pay the exporter for the goods after receiving them.

Features of Bill of Exchange

- It is important to have a bill of exchange in writing
- It must contain a confirm order to make a payment and not just the request
- The order should not have any condition
- The bill of exchange amount should be definite
- Fixed date for the amount to be paid
- The bill must be signed by both the drawee and the drawer
- The amount stated on the bill should be paid on-demand or on the expiry of a fixed time
- The amount is paid to the beneficiary of the bill, specific person, or against a definite order

Types of Bill of Exchange

- **Documentary Bill-** In this, the bill of exchange is supported by the relevant documents that confirm the genuineness of sale or transaction that took place between the seller and buyer.
- **Demand Bill-** This bill is payable when it demanded. The bill does not have a fixed date of payment, therefore, the bill has to be cleared whenever presented.
- **Usance Bill-** It is a time-bound bill which means the payment has to be made within the given time period and time.
- **Inland Bill-** An Inland bill is payable only in one country and not in any other foreign country. This bill is opposite to the foreign bill.
- **Clean Bill-** This bill does not have any proof of a document, so the interest is comparatively higher than the other bills.
- **Foreign Bill-** A bill that can be paid outside India is termed as a foreign bill. Two examples of a foreign bill are an export bill and import bill.
- **Accommodation Bill-** A bill that is sponsored, drawn, accepted without any condition is known as an accommodation bill.
- **Trade Bill-** This kind of bill is specially related only to trade.

➢ **Supply Bill-** The bill that is withdrawn by the supplier or contractor from the government department is known as the supply bill.

Advantages of Bill of Exchange

➢ **Legal Document-** It is a legal document, and if the drawee fails to make the payment, it will be easier for the drawer to recover the amount legally.

➢ **Discounting Facility-** In cases where the drawer is in immediate need of money, the bill can be converted into cash by discounting it from a bank by paying some nominal charges.

➢ **Endorsement Possible-** This bill of exchange can be exchanged from one individual to another for the adjustment of the debt.

Bill of Exchange Format

Bangalore
1st June, 2018

₹4,00,000

Two months after date, pay to me or my order, the sum of
Rupees Four lakh only, for value received

STAMP

Accepted
(Signed)
Raj Kiran
14, Bangalore

(Signed)
Kunal Singh
Lal Bagh, Bangalore

In the above-mentioned bill of exchange format, Kunal Singh is the drawer as well as the payee of the bill.

Difference Between Bill of Exchange and Promissory Note

Sr. No.	On the Basis of	Bill Of Exchange	Promissory Notes
1.	**Definition**	A negotiable instrument issued to order the debtor to pay the creditor a certain sum of money within a specific date or on demand.	A negotiable instrument issued by the debtor with a written promise to pay the creditor a certain amount within a specific date or on demand.
2.	**Section**	Mentioned in Section 5 of the Negotiable	Mentioned in Section 4 of the Negotiable Instruments Act, 1881

		Instruments Act, 1881	
3.	**Issued By**	Creditor	Debtor
4.	**Parties Involved**	Three parties involved i.e a drawer, the drawee and a payee.	Two parties involved i.e a drawer/maker and the payee
5.	**Acceptance**	Drawee needs to accept the bill of exchange before payment.	No acceptance required from the drawee.
6.	**Liability**	Liability of drawer is secondary and conditional.	Liability of drawer is primary and absolute.
7.	**Dishonour of instrument**	Notice served to all the concerned parties involved in the transaction on dishonour the instrument.	No notice served to the drawer in case of dishonour the instrument.
8.	**Copies**	Bill of exchange can have copies.	The promissory note allows no copies.
9.	**Is it Payable to drawer/maker**	Yes, the same person can be drawer and payee.	The same person cannot be drawer and payee.

RIGHTS AND LIABILITIES OF PARTIES

Until the instrument is duly satisfied, every prior party to a negotiable instrument has a liability towards the holder in due course. The prior parties include the maker or drawer, the acceptor and all the intervening endorsers. Also, there liability to a holder in due course is joint and several. They are:

1. Liability of Drawer (Section 30)
2. Liability of the Drawee of Cheque (Section 31)
3. Liability of Acceptor of Bill and Maker of Note (Section 32)
4. Liability of Endorser (Section 35)

5. Liability of Prior Parties (Section 36)
6. Liability Inter-se
7. Liability of Acceptor when Endorsement is Forged (Section 41)
8. Acceptor's Liability when Bill is drawn in a Fictitious Name

1. **Liability of Drawer (Section 30)** Drawer means a person who signs a cheque or a bill of exchange ordering his or her bank to pay the amount to the payee.

   In case of dishonour of cheque or bill of exchange by the drawee or the acceptor, the drawer of such cheque or bill of exchange needs to compensate the holder such amount. But, the drawer needs to receive due notice of dishonour.

So, the nature of the drawer's liability on drawing a bill is:

- On due presentation:- It should be accepted and paid accordingly.
- In the case of dishonour:- Drawer needs to compensate the holder such amount, only when he receives a notice of dishonour by the drawee.

2. Liability of the Drawee of Cheque (Section 31)

The person who draws a cheque i.e drawer having sufficient funds of the drawer in his hands properly applicable to the payment of such cheque must pay the cheque when duly required to do so and, or in default of such payment, he shall compensate the drawer for any loss or damage caused by such default.

The drawee of a cheque will always be a banker. As a cheque is a bill of exchange, drawn on a specified banker by the drawer, the banker is bound to pay the cheque of the drawer, i.e., the customer. For the following conditions are need to be satisfied:

- Sufficient amount of funds to the credit of customer's account should be there with the banker.
- Such funds are required to be properly applied against the payment of such cheque, e.g., the funds are not under any kind of lien etc.
- The cheque is duly required to be paid, during banking hours and on or after the date on which it is made payable.

If the banker unjustifiably refuses to honour the cheque of its customer, it shall be liable for damages.

3. Liability of Acceptor of Bill and Maker of Note (Section 32)

As per section 32 of negotiable instrument act, in the absence of a contract to the contrary, the maker of a promissory note and the acceptor before the maturity of a bill of exchange are under the liability to pay the amount thereof at maturity.

They need to pay the amount according to the apparent tenor of the note or acceptance respectively. The acceptor of a bill of exchange at or after maturity is liable to pay the amount thereof to the holder on demand.

The liability of the acceptor of a bill or the maker of a note is absolute and unconditional but is subject to a contract to the contrary and may be excluded or modified by a collateral agreement.

4. Liability of Endorser (Section 35)

An endorser is the one who endorses and delivers a negotiable instrument before maturity. Every endorser has a liability to the parties that are subsequent to him.

Also, he is bound thereby to every subsequent holder in case of dishonour of the instrument by the drawee, acceptor or maker, to compensate such holder of any loss or damage caused to him by such dishonour. However, he is to compensate only after the fulfillment of the following conditions:

- There is no contract to the contrary
- The Endorser has not expressly excluded, limited or made conditional his own liability
- And, such endorser shall receive due notice of dishonour.

5. Liability of Prior Parties (Section 36)

Until the instrument is duly satisfied, every prior party to a negotiable instrument has a liability towards the holder in due course. The prior parties include the maker or drawer, the acceptor and all the intervening endorsers. Also, there liability to a holder in due course is joint and several. In the case of dishonour, the holder in due course may declare any or all prior parties liable for the amount.

6. Liability Inter-se

Every liable party has a different footing or stand with respect to the nature of liability of each one of them.

7. Liability of Acceptor when Endorsement is Forged (Section 41)

An acceptor of a bill of exchange who had already endorsed the bill is not relieved from liability even if such endorsement is forged. This is so even if he knew or had reason to believe that the endorsement was forged when he accepted the bill.

8. Acceptor's Liability when Bill is drawn in a Fictitious Name

An acceptor of a bill of exchange who draws a bill in a fictitious name, payable to the drawer's order will be liable to pay any holder in due course. He or she will not be relieved from such liability by reason that such name is fictitious.

BILLS DISCOUNTING AND PURCHASING

Bills Discounting

Bill discounting is a trade-related activity in which a company sells its outstanding invoices to a financier (a bank or another financial institution) that agrees to pay the company for them at a future date.

In bill discounting, the business discount the outstanding invoices to gain access to short-term financial assistance and maintain the working capital. This process is also called “Invoice Discounting”. This process is governed by the negotiable instrument act, 2010. Factoring & Reverse Factoring are two methods a bill is discounted on TReDS platorm. Both the methods are designed to speed up and increase cash flow without disturbing the balance sheet.

Factoring is a financial transaction and a type of debt or finance in which a business sell sits accounts receivable (i.e., invoices) to a third party (called a factor) at a discount. Benefits of factoring is working capital optimization, credit protection against bad debts, No collateral required, prompt payments for your invoices.

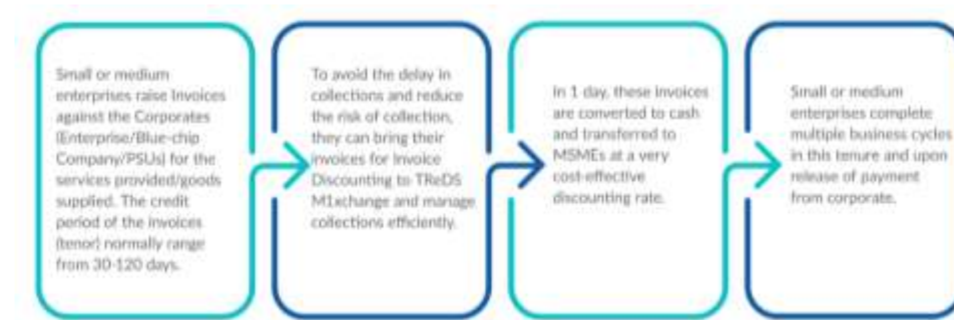
Reverse factoring, also known as supply chain finance or supplier finance, is a financial technology solution that mitigates the negative effects of longer payment terms to help buyers and suppliers optimize working capital. Benefits of reverse factoring Improved cash flows, reduce dearly payment requests, Low interest rate of interest, Develop long term relationships.

Example of Bill Discounting

Suppose, a business man sold goods to Mr.X worth Rs 10,000 on credit but Mr.X does not have the money to pay today, but he is certain to pay on a later date, afer two months, so the bill is raised stating Mr.X to pay Rs 10,000 afer two months. But an urgent need for funds is required by businessman, and he can’t wait for two months, there by he discounts this bill with his bank/**Bill discounting** company two months before its due date @ 15% P.A rate of discount.Now the bank pays the drawer an amount of Rs 9750 afer deducting an applicable commission of Rs 250.

Businessman (drawer) sold goods and also got paid without having to lose either his customer or the business. Mr. X got the goods not having paid today, and the bank made a good commission.

Bill Discounting Process



Advantages of Bill Discounting

Bill discounting is advantageous to businesses, banks, finance companies, and investors. Businesses benefit by rejuvenating their cash-flow in-turn helping them stabilize growth and fund business expenditure.

Cash flow: Businesses being dependent on the cash flow to sustain their business can easily rely on this quick financial aid to access speedy funds and continue to flourish. This process quickens money inflow— profiting the organization in expanding deals, seeking after development, securing hardware, etc.

a. **Instant access to cash:** Bill discounting is a more efficient, faster way of assessing working capital as it is hassle-free and does not involve the lengthy documentation procedure. With Exchange, businesses can secure financial assistance in just 24 to 72 hours.
b. **No collateral involved**: here is no requirement to keep any asset as security as the unpaid invoice is considered as the collateral itself.
c. **No debt incurred**: Bill discounting helps in saving tax liability. The chances of a company suffering any loss or damage are almost nonexistent when compared to conventional financing frameworks.
d. **No impact on the balance sheet:** Bill discounting service offered by M1xchange does not impact the balance sheet of the business as it is an off-the-book process.

Bill Discounting Features

Bill discounting can be a great way to help manage cash flow and get ahead on bills, but there are some essential features to -

- Bill discounting is a short-term lending product that allows you to pay off your bills in advance.
- You can use this service for any debt, including credit cards, loans, and mortgages.
- The benefit of paying off your bills early is that you will save money on interest rates and prevent late fees from accruing.

Key Differences Between Bill Purchase and Bill Discounting

- Bill discounting involves the bank providing funds to the seller based on the discounted value, while bill purchase involves the bank purchasing the bill from the seller for the purchase price.
- In bill discounting, the seller is still responsible for collecting payment from the buyer when the bill matures, whereas, in bill purchase, the bank assumes the responsibility of collecting the payment.
- Bill discounting involves deducting a discount from the face value of the bill, while bill purchase involves buying the bill at a price lower than the face value.

Both bill discounting and bill purchase offer sellers immediate funds, but the main difference lies in who takes the responsibility for collecting payment and the financial arrangement between the bank and the seller.

How Do They Work: Bill Discounting vs Bill Purchase?

1. Invoice Discounting

- Your business prepares invoices against the credit sale of goods or services.
- You share the invoice details and corresponding bills with your lender.
- This institution assesses the invoices and provides cash advances at a discounted rate against their value.
- Your business's credit controller then sets to collect payments from the debtors.
- When the invoices are settled, you repay the lender such a loan amount.

The cash advance you receive via the bill discounting facility does not involve any spending constraints. Thus, you can channel this fund for any purpose, like paying suppliers, undertaking a new venture, etc.

2. Bill Purchase

- Invoice is generated against the sale of goods and services on credit.
- You sell the bills to the factor.
- This financial institution analyses the invoices and provides a percentage, let's say 80% of their value as a cash advance.
- Such a lender then initiates the payment collection process.
- When your customers or debtors clear up payment, the factor forwards you the remaining 20% of the invoice value, minus the service fee or interest.

Similar to bill discounting, there's no end-use restriction involved with the invoice factoring facility.

Pros and Cons of Bill Discounting and Purchase

Some common advantages of both these financing options are:

- They provide access to instant financing without any collateral.
- Businesses can streamline their cash flow with ease and efficiency, especially if credit terms vary across clients.
- They do not encumber the finances of a business.

When considering whether to go with bill discounting or purchase-

1. **Customer Relationship** With bill discounting, you undertake the responsibility of outstanding payment collection from your customers. Since it is confidential, your customer relationship remains unaffected.
   In the case of bill factoring, the lender collects the outstanding payment. Thus, your customer relationship may be affected.
2. **Payment Collection** Your business may benefit from the expertise of a lending institution in terms of payment collection, but that may not always be the case. Thus, you may opt to go with bill purchases if you think their payment collection process can be more effective than otherwise.

On the other hand, you might choose to stick with bill discounting if you wish to retain the responsibility to collect payments from debtors.

ANCILLARY SERVICES OF THE BANKERS

Ancillary services are other services that banks offer to common men along with the necessary banking services. These ancillary services form a very minuscule of the services offered by the banks. Some of the ancillary services provided by the banks are:

Funds transfer service: Useful for sending and receiving money from all over the world.

Forex service: You can buy the foreign exchange for any purpose of expenditures like travel, buying merchandise, etc. and sell the same to the bank when you earn or receive from abroad.

Custodial Service: You can keep your valuables like jewels, documents, etc. Under this service, this is commonly known as Locker facility (Safe Deposit Vaults).

e-banking: also known as Net banking or Internet banking is the latest and most convenient facility of the banks .You can get id and password to operate your account online : for transfer of funds to another account in the same bank or another bank. You can keep the surplus funds in fixed deposit by using this facility.

In Detail -

Remittance services

- It means a transfer of funds from one branch of a bank to another branch of the same bank or a different bank.
- One can make local remittances through Bankers Cheque (BC) and remit funds from one centre to another through Demand drafts (DD), Telegraphic Transfer (TT), Mail Transfer (MT), National Electronic Fund Transfer (NEFT) and Real Time Gross Settlement (RTGS) at specified service charges.

- The customer shall fill in full particulars regarding the remittance; such as-
- Nature of the remittance i.e. by filling in DD/TT/MT etc.
- Name and address of the beneficiary.
- Name of the branch to which the remittance is to be made.
- Name, address, an account number of the remitter/customer if required.

Custodial Services

- This facility is popularly known as Safe Deposit Locker.
- It is extended to the customers to enable them to keep their valuables/important documents in a specially designed locker. A prescribed rental is charged on them.
- Lockers can be hired by individuals (not minors), firms, limited companies, specified associations and societies.
- Lockers can be rented for a minimum period of one year.
- There are four different types of lockers i.e. small, medium, large and extra large with varying rentals.
- Nomination facility is available to an individual hirer.
- In a case of overdue rents bank can charge a penalty.

Forex Services

- When a person travels to different countries or wants to buy any foreign merchandises, then they require foreign currencies.
- Bank provide these currencies to its customers.
- All transactions are done over the counter and only authorised bank branches can perform these functions.
- When a person earns or receives foreign currencies from abroad, he can also send them to banks.
- These foreign exchange transactions are done according to the rules and regulations of the central banks of respective countries.
- In India, all the transactions are subjected to the regulations of Foreign Exchange Management Act (FEMA), 1999.

Card Services

- Primarily the card services were introduced for convenience and safety purposes but nowadays it has become the most popular payment mode among people.
- The bank issues customers two basic types of cards those are credit cards and debit cards.
- With the help of a credit card, the card holder can obtain either goods or services from merchant establishment where such arrangement exists. Then a bill is sent to the cardholder

indicating the dues that he/she has to pay within a period of 30-40 days. It carries a fixed interest.

- Debit cards are same as credit cards. The only difference is that a number of dues for each transaction is debited to card holder's account as each transaction is notified.

e- banking services

- Nowadays it is the most popular method of doing banking operation where you don't need to be physically present in the bank branch for performing any function/operation.
- It is also known as online banking or internet banking.
- One can do a number of activities by just sitting in front of one's computer screen or smartphone. Such as- Transfer of funds from one account to another in the same bank or different banks, Keep surplus funds in a fixed deposit account, Online shopping etc.
- The only thing he/she needs to do is to access his/her virtual account with the help of the ID and PASSWORD, provided by the bank. E-Banking Services

Insurance services

- Banks deliver a wide range of insurance of insurance products that covers the risk of almost every aspect of a human life, such as- Life, Health, Valuable assets like Personal vehicles, Debit and credit cards etc.
- It is also known as Bancassurance in which a bank and an insurance company form a partnership.
- The insurance company sales its different products to the bank's client base.
- This partnership is profitable for both companies. Banks can earn additional revenue by selling the products and the insurance company can expand its customer base.
- Example- ICICI Prudential, Bajaj Allianz etc.
- Some banks also offer Investment services for their corporate customers. It is also known as Portfolio services. They guide their clients especially about how to invest adequately or raise financial capital for their business. Any individual customer can also avail this kind of services from their respective bank.

E-BANKING

Internet-banking or online banking or virtual banking, is an electronic payment system that enables customers of a bank or other financial institution to conduct a range of financial transactions through the financial institution's website.

e-banking is a broad term that includes everything from Internet and Mobile Banking

When did you last visit your bank to change your ATM PIN or update your personal details, such as your registered mobile number? It has been a while for many customers, thanks to the internet. E-banking comes naturally to customers when they need to resolve an issue with their bank or make a financial / non-financial transaction. Given its convenience, the types of E-banking and the problems that it has solved merits an assessment.

What is e-banking?

E-banking is an arrangement between a bank or a financial institution and its customers that enables encrypted transactions over the internet. Short for electronic banking, E-banking has various types that cater to customers' different requirements, which can be resolved online.

E-banking is also helpful for non-financial transactions such as changing your ATM PIN, getting a mini statement, updating your personal details, balance inquiry or printing an account statement. Essentially, it refers to any transaction that doesn't involve any movement of funds to or from your account.

Types of E-banking

The major types of E-banking are online internet banking, mobile banking, automated teller machine (ATM), and debit and credit cards. There's a good chance you've already heard about most of these. However, let's understand each and how they cater to different customer requirements.

Mobile and Internet banking Mobile banking, Internet banking and E-banking are almost synonymous, except the latter is a broader term encompassing the former. Any transaction – financial or non-financial – that you make over through a web page (generally the bank's website) or a web application constitutes internet banking.

On the other hand, credit cards allow customers to borrow funds up to a pre-approved limit and help them avail a range of offers.

ATMs ATM was the first E-banking service provided by banks when they started going digital. An ATM makes the process of withdrawing and depositing money convenient.

Electronic Data Interchange (EDI) EDI is a technology that is restricted to business transactions. It is used to improve operational efficiency and reduce transaction costs across a supply chain consisting of manufacturers, suppliers, logistics providers, retailers, and wholesalers, etc. EDI has succeeded in making transactions across businesses paperless and seamless.

Electronic Fund Transfer (EFT) An EFT is used to electronically transfer money from one bank account to another. Some examples of EFT are National Electronic Funds Transfer (NEFT), Immediate Payment Service (IMPS) and Real-Time Gross Settlement (RTGS). Hence, E-banking comprises a range of different mediums of transacting online.

Why should we prefer E-banking?

E-banking enables digital payments which are secure, transparent, and fast. In addition, E-banking allows you to access your bank account whenever you want to. Add to this the benefit of lower transaction costs on transactions made through E-banking. The instant notifications are also a plus, as they help you know everything about your bank account in real-time.

Significance of e-banking:

Importance to clients:

- **Lower cost per exchange:** Since the client doesn't need to visit the branch for each exchange, it saves him both time and cash.
- **No topographical hindrances:** In conventional financial frameworks, geological distances could hamper specific financial exchanges. Nonetheless, with e-banking, geological obstructions are diminished.
- **Convenience:** A client can get to his record or bank account and execute from any place at any time.

Importance to Businesses:

- **Better efficiency:** Electronic banking further develops usefulness. It permits the computerisation of ordinary, regularly scheduled payments and provides further banking activities to upgrade the efficiency of the business.
- **Lower costs:** Usually, costs in financial relationships and connections depend on the assets used. Assuming that a specific business needs more help with deposits, wire transfers, and so on, then, at that point, the bank charges its higher expenses. With internet banking, these costs are limited.
- **Lesser errors:** Electronic financial diminishes mistakes in normal financial exchanges. Awful penmanship, mixed-up data or information, and so on can cause mistakes that can be

exorbitant. Likewise, a simple audit of the record or account activity, movement upgrades the precision of monetary exchanges.

- **Diminished misrepresentation:** Electronic banking gives an advanced impression to all representatives who reserve the privilege to alter banking exercises. In this manner, the business has better perceivability into its exchanges, making it hard for any fraudsters from committing crimes.
- **Account reviews:** Business proprietors and assigned staff individuals can get to the records rapidly utilising a web-based financial interface. This permits them to audit the record action and, furthermore, guarantee the smooth working of the account.

Importance to banks:

- **Lesser exchange costs:** Electronic exchanges are the least expensive methods of exchange.
- **A decreased edge for human blunder:** Since the data is handed-off electronically, there is no space for human mistakes or errors.
- **Lesser desk work:** Advanced records decrease desk work, paperwork, and make the cycle simpler to deal with. Likewise, it is ecological.
- **Decreased fixed expenses:** A lesser requirement for branches which converts into a lower fixed expense.
- **More steadfast clients:** Since e-banking administrations or services are convenient to the clients, banks experience higher reliability from their clients.

Unit IV

EMPLOYMENT OF FUNDS BY COMMERCIAL BANKS

The employment or investment of funds by a commercial bank means the safe utilization and profitable use of its funds. The bank obtains money from different sources and pays interest on them.

The employment or investment or advancing of funds by a commercial bank means the safe utilization and profitable use of its funds. The bank, as we know, obtains money from different sources and pays interest on them. It is the utmost desire of every commercial bank that it should invest its funds in a manner which serves its own as well as Customer's interest. Its own interest is to earn profit for the shareholders. The other interest is of the customers. The bank should keep sufficient cash at its disposal to pay back money to the customers along with interest as and when demanded by them. These two objectives of liquidity and profitability are obtained by utilizing the surplus funds into ready convertible securities. The main types of earning assets of a bank are as follows

- money at call and short notice
- investment in government and semi government securities
- short and medium term loans
- Discounting of bills.

Factors of Good Advancing.

The primary purpose of the bank is to grant loans to households, firms and companies. A major portion of its funds is used for giving loans. Loans are the major source of income of the bank.

However, the lending of money is not without risk. A bank takes a number of **precautions** while sanctioning loans. The main considerations or factors which are taken into account while lending money by the bank are as follows:--

(1) Liquidity Liquidity is the first and the most important principle of bank's investment policy. By liquidity is meant the relative ease and speed with which an asset can be converted into cash without incurring large costs. If is the policy of every commercial bank that it should invest its surplus funds in those assets which can be easily converted into cash and also yield profit. The reason behind it is that if the bank's investments are not in liquid form, it may fail to meet its obligations towards its depositors. This may land the bank into difficultly. Every bank therefore, tries to invest its funds into ready convertible securities and not in immovable properties.

(2) Safety The principle of safety is of utmost importance for investment of funds by a bank. The bank, in its lending activity, takes into account the borrower's ability to pay the loan. It also sees that in case of nonpayment of loan, the security offered can be disposed of without loss and delay.

(3) Profitability Banking is a business. Like any other business, it also aims at earning profit. Profit can only be earned if a major portion of the deposits are invested in securities yielding high returns. While making advances,

the bank cannot ignore this aspect that the funds invested remain fairly safe, liquid and give also a reasonable return. In order to achieve this objective, the bank keeps in its investment portfolio three types of investments, liquid, semi liquid and income earning investment.

(4) Purpose of loan While advancing money, the banker must examine and investigate the purpose of the loan. If the loan is for productive purposes, it will not only ensure the safety of money but also provide a definite source of repayment. Truly speaking, short term productive loans are ideal loans. The advances for hoarding, or for speculative activities, for marriages, pleasure tours etc., etc. are not safe and liquid. As such these should be discouraged.

(5) Security The banker advances loans by considering the credit worthiness, honesty, good-will, business integrity of the borrower. Apart from these attributes in credit selection, the banker as for as possible secures loan by getting tangible security from the borrower. The security is considered as an insurance against risk of non-payment of loan. The banker is to see that the security offered against loan is adequate, highly liquid, easy to handle and free from any default.

(6) Spread of Risk An element of risk is present in every advance, however, secure it may be. It is therefore advised that the loans should be spread over

- large number of borrowers
- over a large number of industries
- over a large number of areas (villages towns, cities etc.) Diversification of advances thus minimizes the risk of defaults of loans.

(7) Management of Cash Reserve A bank has to keep a certain minimum percentage of its deposits in ready cash to meet it liability towards depositors. There is, however no limit on the maximum reserve to be kept by it. The bank, therefore, through its experience must keep an effective amount to meet the liability of the depositors.

(8) National Interest The loans should be advanced keeping in view the national interest of the country If central bank directs that advances be given to small scale industries and agriculture and for export, the instructions should be followed in the national interest.

SECURITIES

Securities refer to tradable financial instruments or assets that have economic value. Companies issue these instruments to raise capital for financing their activities. Common examples include stocks, bonds, options, etc. The Securities and Exchange Commission (SEC) regulates the issue of such financial instruments in the United States.

Types Of Securities

There are four main types of security:

1. Debt Securities
2. Equity Securities

3. Derivative Securities
4. Hybrid Securities, which are a combination of debt and equity.

Debt Securities

Debt securities, or fixed-income securities, represent money that is borrowed and must be repaid with terms outlining the amount of the borrowed funds, interest rate, and maturity date. In other words, debt securities are debt instruments, such as bonds (e.g., a government or municipal bond) or a certificate of deposit (CD) that can be traded between parties.

Debt securities, such as bonds and certificates of deposit, as a rule, require the holder to make the regular interest payments, as well as repayment of the principal amount alongside any other stipulated contractual rights. Such securities are usually issued for a fixed term, and, in the end, the issuer redeems them.

A debt security's interest rate on a debt security is determined based on a borrower's credit history, track record, and solvency – the ability to repay the loan in the future. The higher the risk of the borrower's default on the loan, the higher the interest rate a lender would require to compensate for the amount of risk taken.

It is important to mention that the dollar value of the daily trading volume of debt securities is significantly larger than stocks. The reason is that debt securities are largely held by institutional investors, alongside governments and not-for-profit organizations.

Equity Securities

Equity securities represent ownership interest held by shareholders in a company. In other words, it is an investment in an organization's equity stock to become a shareholder of the organization.

The difference between holders of equity securities and holders of debt securities is that the former is not entitled to a regular payment, but they can profit from capital gains by selling the stocks. Another difference is that equity securities provide ownership rights to the holder so that he becomes one of the owners of the company, owning a stake proportionate to the number of acquired shares.

In the event a business faces bankruptcy, the equity holders can only share the residual interest that remains after all obligations have been paid out to debt security holders. Companies

regularly distribute dividends to shareholders sharing the earned profits coming from the core business operations, whereas it is not the case for the debt-holders.

Derivative Securities

Derivative securities are financial instruments whose value depends on basic variables. The variables can be assets, such as stocks, bonds, currencies, interest rates, market indices, and goods. The main purpose of using derivatives is to consider and minimize risk. It is achieved by insuring against price movements, creating favorable conditions for speculations and getting access to hard-to-reach assets or markets.

Formerly, derivatives were used to ensure balanced exchange rates for goods traded internationally. International traders needed an accounting system to lock their different national currencies at a specific exchange rate.

There are four main types of Derivative Securities:

1. **Futures** Futures, also called futures contracts, are an agreement between two parties for the purchase and delivery of an asset at an agreed-upon price at a future date. Futures are traded on an exchange, with the contracts already standardized. In a futures transaction, the parties involved must buy or sell the underlying asset.
2. **Forwards** Forwards, or forward contracts, are similar to futures, but do not trade on an exchange, only retailing. When creating a forward contract, the buyer and seller must determine the terms, size, and settlement process for the derivative.

   Another difference from futures is the risk for both sellers and buyers. The risks arise when one party becomes bankrupt, and the other party may not able to protect its rights and, as a result, loses the value of its position.

3. **Options** Options, or options contracts, are similar to a futures contract, as it involves the purchase or sale of an asset between two parties at a predetermined date in the future for a specific price. The key difference between the two types of contracts is that, with an option, the buyer is not required to complete the action of buying or selling.
4. **Swaps** Swaps involve the exchange of one kind of cash flow with another. For example, an interest rate swap enables a trader to switch to a variable interest rate loan from a fixed interest rate loan, or vice versa.

Hybrid Securities

Hybrid security, as the name suggests, is a type of security that combines characteristics of both debt and equity securities. Many banks and organizations turn to hybrid securities to borrow money from investors.

Similar to bonds, they typically promise to pay a higher interest at a fixed or floating rate until a certain time in the future. Unlike a bond, the number and timing of interest payments are not guaranteed. They can even be converted into shares, or an investment can be terminated at any time.

Examples of hybrid securities are preferred stocks that enable the holder to receive dividends prior to the holders of common stock, convertible bonds that can be converted into a known amount of equity stocks during the life of the bond or at maturity date, depending on the terms of the contract, etc.

Hybrid securities are complex products. Even experienced investors may struggle to understand and evaluate the risks involved in trading them. Institutional investors sometimes fail at understanding the terms of the deal they enter into while buying hybrid security.

How To Trade In Securities?

Marketable securities can be bought and sold through many options, depending on the asset. For example, stocks can be traded via stock exchanges, whereas bonds can be bought from the government. However, in some countries, investors can buy bonds only through brokers.

Nevertheless, let's understand the structure of the market. First, private firms have to become publicly listed to be able to raise capital from the public. This is done through an initial public offering (IPO). Then, investors can buy the assets from the company directly in the primary market.

These investors can later sell the assets in the secondary market at their market price. Further buying and selling take place in the secondary market itself. Equity shareholders receive a share of the net profits, and creditors are paid the loan interest.

Securities vs Stocks

A financial instrument traded for monetary or economic value can be a security. A stock is such an instrument. Therefore, a stock is a security, but not all securities are stocks.

Financial instruments can vary in risk, returns, nature, and many other factors. But stocks are usually high-risk assets associated with higher returns. Also, not all instruments confer ownership rights to the investors. Such a feature is only associated with stocks.

MODE OF CREATING CHARGE

Various modes of creating a charge by bank are:

Types of Charges

Bank charge over properties confines itself to one or more of the following five types of charges.

1. Assignment
2. Lien
3. Hypothecation
4. Pledge
5. Mortgage

1. **Assignment** It is a mode of providing security to a bank for an advance. It is transfer of a right of property or a debt. The transferor is called assignor and the transferee is called assignee.

   Borrowers generally assign the actionable claims to the banker as security for an advance. In banking practice, a borrower may assign the book debt, money due from government department and life insurance policies as security for an advance.

   As regard to the mode of assignment, no particular form or words is necessary for effecting an assignment, if the intention is clear from the language used. An assignment can be absolute or by the way of security.

   An assignment may be legal or equitable assignment. A legal assignment is the absolute transfer of an actionable claim, must be in writing and signed by the assignor. The assignor informs his debtor, also in writing, intimating the assignee's name and address. The assignee also serves a notice on the debtor and seeks his confirmation of balance assigned. If the formality is not fulfilled, the assignment is called an equitable assignment. Banks generally go in for legal assignment and insist for obtaining an acknowledgement of assignment from the debtor.

2. **Lien** Lien is the right of the banker to retain possession of the goods and securities owned by the debtor until the debt due from the latter is paid. For example, while

giving loan against shares banks obtain letter of consent from borrower to the concerned company for the lien over shares in favor of lender and accretion (dividend, bonus shares, right shares). The bank's lien is an implied pledge. A banker acquires the right to sell the goods which came into its possession in the ordinary course of banking business, in case the debt is not paid.

However, when a customer inadvertently leaves a packet containing certain share certificates, life insurance policies, fixed deposit receipts of other banks, etc. while leaving the bank premises, the bank will have no right of lien over those securities because those were not given to the bank in the normal course of banking business.

3. **Hypothecation:** It is a mode that creates charge on goods or related documents without surrendering the possession of goods. It is a legal transaction where goods may be made available as security for a debt without transferring the property or possession to the lender. It is the borrower who keeps the possession of hypothecated goods. For the debt amount, an equal charge is created on the goods.

   Hypothecator is the borrower who hypothecates the goods and hypothecates is the lender. The borrower performs this method by using a document in favor of the lender called letter of hypothecation. Letter states that the said goods or property are at order and disposition of the lender until the debt is cleared. This method is said to be a risky one and that is why regular inspection and physical verification should be done of the hypothecated goods by the bank.

   This form of charge is ideal from the point of view of the borrower as he is always in control of goods offered as security to the bank. In case of default by the borrower, the bank can take possession of goods and convert it to pledge.

4. **Pledge:** Pledge is said to be a bailment of goods as security for payment of a debt or performance of a promise. Pledged is the borrower who pledges the property and pledgee is the person with whom the property in pledged. Two important features of pledge are delivery of goods and return of goods.

   Ownership of goods is not given and only possession over the goods is given, when goods are pledged. The pledger remains the owner of the property. This method is said to be very popular and simple in order to secure a charge on the property. The bank has the right to retain the security only in case of a particular debt for which goods are pledged.

5. **Mortgage:** It means transferring interest in a specific immovable property by one person to another with a vie to secure an advance of money. Mortgagor is the transferor and mortgagee is the transferee. Mortgage deed is said to bean instrument with the help of which the

mortgage is effected. Mortgage money means the advance of money by which the mortgage is effected.

It is not necessary that possession of the property is always transferred to the mortgagee. Possession remains with the mortgagor. Mortgagee has the right, as per which he can sell of the property and recover his loan. Interest that lies in the property is conveyed to the mortgagor, when amount of loan with the interest is repaid by the borrower.

Mortgage have following types -

a) Simple mortgage,
b) Usufructuary mortgage,
c) English mortgage,
d) Mortgage by conditional sale,
e) Anomalous mortgage
f) Equitable mortgage.

a) Simple Mortgage “a mortgage where, without delivering possession of the mortgaged property, the mortgagor binds himself personally to pay the mortgage money, and agrees, expressly or impliedly, that, in the event of his failure to pay according to his contract, the mortgagee shall have a right to cause the mortgaged property to be sold and the proceeds of the sale to be applied, so far as may be necessary, in payment of the mortgage money, the interest thereon, and the costs of such sale.”

b) Usufructuary Mortgage A usufructuary mortgage is a contract where the borrower transfers possession and usage rights of a property to the lender while retaining ownership. The lender, known as the mortgagee, is granted the right to enjoy the income or produce generated by the property during the mortgage period.

c) English Mortgage An English mortgage transaction is a lawful sale in which the mortgagor conveys the property to the lender with the legally enforceable promise that, upon the lender's receipt of the money on a specific date, the lender would re-transfer the property to the mortgagor.

d) Mortgage By Conditional Sale In a mortgage by conditional sale, the mortgagor sells the mortgage property on a condition that states that on default of payment of mortgage by the set date, the sale will become absolute.

e) Anomalous mortgage A mortgage which is not a simple mortgage, a mortgage by conditional sale, an usufructuary mortgage, an English mortgage or a mortgage by deposit of title-deeds within the meaning of this section is called an anomalous mortgage.

f) **Equitable Mortgage** It is also known as Mortgage by deposit of title deeds, it is a process where a borrower deposits their property's title deed with the lender as security for a loan until it is repaid. Equitable mortgage charges create a charge on the property without the need for legal procedures.

BANK GUARANTEES

A guarantee given by the bank on behalf of the applicant to cover a payment obligation to a third party. In other words, the bank becomes a guarantor and is answerable for the person requesting the guarantee in the event that they are unable to make the payment they have agreed with a third party.

Bank guarantees represent a more significant contractual obligation for banks than letters of credit do. A bank guarantee, like a letter of credit, guarantees a sum of money to a beneficiary. The bank only pays that amount if the opposing party does not fulfill the obligations outlined by the contract. The guarantee can be used to essentially insure a buyer or seller from loss or damage due to nonperformance by the other party in a contract.

Bank guarantees protect both parties in a contractual agreement from credit risk. For instance, a construction company and its cement supplier may enter into a contract to build a mall. Both parties may have to issue bank guarantees to prove their financial bona fides and capability. In a case where the supplier fails to deliver cement within a specified time, the construction company would notify the bank, which then pays the company the amount specified in the bank guarantee.

Kinds of Bank Guarantees that Cover Various Risks-

- **Performance bond guarantee:** Serves as collateral for the buyer's costs if services or goods are not provided as agreed in the contract.
- **Advance payment guarantee:** Acts as collateral for reimbursing the buyer's advance payment if the seller does not supply the specified goods per the contract.
- **Warranty bond guarantee:** Serves as collateral, ensuring ordered goods are delivered as agreed.
- **Payment guarantee**: Assures a seller the purchase price is paid on a set date.
- **Rental guarantee:** Serves as collateral for rental agreement payments.
- **Shipping guarantees:** This kind of guarantee is given to the carrier for a shipment that arrives before any documents are received.
- **Loan guarantees:** An institution that issues a loan guarantee pledges to take on the financial obligation if the borrower defaults.

- **Advanced payment guarantees:** This guarantee acts to back up a contract's performance. Basically, this guarantee is a form of collateral to reimburse advance payment should the seller not supply the goods specified in the contract.
- **Confirmed payment guarantees:** With this irrevocable obligation, a specific amount is paid by the bank to a beneficiary on behalf of the client by a certain date.

LETTER OF CREDIT

Sometimes referred to as documentary credit, a letter of credit acts as a promissory note from a financial institution—usually a bank or credit union. It guarantees a buyer's payment to a seller or a borrower's payment to a lender will be received on time and for the full amount. It also states that if the buyer can't make a payment on the purchase, the bank will cover the full or remaining amount owed.

A letter of credit represents an obligation taken on by a bank to make a payment once certain criteria are met. After these terms are completed and confirmed, the bank will transfer the funds. The letter of credit ensures the payment will be made as long as the services are performed. The letter of credit basically substitutes the bank's credit for that of its client, ensuring correct and timely payment.

Types of Letters of Credit

Just like bank guarantees, letters of credit also vary based on the need for them. The following are some of the most commonly used letters of credit:

- An **irrevocable letter of credit** ensures the buyer is obligated to the seller.
- A **confirmed letter of credit** comes from a second bank, which guarantees the letter when the first one has questionable credit. The confirming bank ensures payment in the event the company or issuing bank default on their obligations.
- An **import letter of credit** allows importers to make payments immediately by providing them with a short-term cash advance.
- An **export letter of credit** lets the buyer's bank know it must pay the seller, provided all the conditions of the contract are met.
- A **revolving letter of credit** lets customers make draws within limits during a certain time period.

Bank Guarantee vs. Letter of Credit

A bank guarantee and a letter of credit are both promises from a financial institution that a borrower will be able to repay a debt to another party, no matter the debtor's financial circumstances. While different, both bank guarantees and letters of credit assure the third party

that if the borrowing party can't repay what it owes, the financial institution will step in on behalf of the borrower.

By providing financial backing for the borrowing party (often at the request of the other one), these promises serve to reduce risk factors, encouraging the transaction to proceed. But they work in slightly different ways and in different situations.

Letters of credit are especially important in international trade due to the distance involved, the potentially differing laws in the countries of the businesses involved, and the difficulty of the parties meeting in person. While letters of credit are primarily used in global transactions, bank guarantees are often used in real estate contracts and infrastructure projects.

BASEL NORMS

Basel norms are an attempt to harmonise banking regulations around the world. The goal is to strengthen the international banking system and improve the quality of banking worldwide.

These norms focus on the risks to banks and the whole financial system.

Basel Norms

- It also refers to Basel Accords or Basel Guidelines on banking supervision. These guidelines are formulated by the Basel Committee on Banking Supervision (BCBS).
- These norms are for individual banks and Systemically Important Financial Institutions (SIFI).
- In India, these norms are implemented by the Reserve Bank of India. As of now, the committee has come up with Basel-I, Basel-II and Basel-III.
- RBI began implementing Basel-I in 1992 and Basel-II in 2009. RBI also issued guidelines on implementing Basel-III in a phased manner.

Basel -I Norms

- It is also known as the Basel Capital Accord.
- As per Basel-I, all banks were required to maintain a capital adequacy ratio (CAR) of 8 %.

1. CAR is the minimum capital requirement of a bank and is defined as the ratio of capital to risk-weighted assets (RWA).
2. RWA is the assets weighted or classified according to the risk (default) profile.

- It also classified bank capital into Tier-I and Tier-2 Capital.

1. Tier 1 capital is the core capital of banks and is more permanent in nature (e.g. equity capital, disclosed reserves, etc.).

2. Tier 2 capital is supplementary in nature and is fluctuating in nature (e.g. undisclosed reserves, cumulative non-redeemable preference shares, etc.).

- India adopted Basel -I guidelines in 1999.

Basel-II Norms

- It is the revised capital framework of 1988. It comprises three pillars: Pillar 1 (Minimum Capital Requirement), Supervisory Review, and Market Discipline.

Pillar 1: Minimum Capital Requirement (MCR)

- It sets MCR for credit risk, market risk and Operational risk.
- As per Basel-II, the minimum capital requirement is 8% of the risk-weighted assets. Risk-weighted assets means -Classification of assets based on their risk profiles.
- The capital ratio is calculated using the definition of regulatory capital and risk-weighted assets.
- The total capital ratio must not be lower than 8%.
- It also extends banks capital to Tier 3 capital (existing Tier 1 and Tier 2 capital).
- Tier-3 capital includes short-term subordinated loans (lower in ranking).
- Tier 3 capital solely to support market risks.
- For short-term subordinated debt to be eligible as Tier 3 capital, it needs to be capable of becoming part of a bank's permanent capital and thus be available to absorb losses in the event of insolvency.

Pillar 2: Supervisory review

- It focuses on supervision of institution's implementing Pillar-1 guidelines. Under it, Banks were required to develop and use better risk management techniques.

Pillar 3: Market Discipline

- It is designed to promote greater stability in the financial system. It increased the disclosure requirements.
- Banks need to mandatorily disclose their CAR, risk exposure, etc to the central bank.

Basel III Norms

- The financial crisis of 2007-08 revealed shortcomings in the Basel norms. Therefore, the previous accords were strengthened in Basel III.
- **Increase the level and quality of capital:** Banks are required to maintain more capital of higher quality to cover unexpected losses. Moreover, the minimum Tier 1 capital rises from 4% to 6%. It has also mandated that the Global systemically important banks (G-SIBs)are subject to additional capital requirements.

- **Maintain Buffer to absorb unexpected loss:** Banks have to maintain a capital conservation buffer of 2.5% of RWA. Moreover, banks have to maintain a countercyclical buffer of 0-2.5%.
- **Improving Bank Liquidity:** It created two liquidity ratios: Liquidity coverage Ratio (LCR) and Net Stable Funding Ratio (NSFR).

1. LCR will require banks to have sufficient high-quality liquid assets to withstand a 30-day stressed funding scenario that is specified by supervisors. This is to deal with the cash outflows encountered in an acute short term stress scenario.
2. NSFR requires banks to maintain a stable funding profile in relation to their off-balance-sheet assets and activities. NSFR requires banks to fund their activities with stable sources of finance (reliable over the one-year horizon).
   - **Leverage:** A non-risk based leverage ratio including off-balance sheet exposures is meant to serve as a backstop to the risk-based capital requirement.

FINANCIAL SECTOR REFORMS IN INDIA

Financial Sector Reforms are the steps taken to change the banking system, capital market, government debt market, foreign exchange market, etc. An efficient financial sector enables the mobilization of household savings and ensures their proper utilization in productive

sectors. This article will discuss the various aspects of financial sector reforms related to the economic reforms of 1991 which are necessary to understand for UPSC exam preparation.

- The financial sector constitutes the commercial banks, non-banking financial companies, investment funds, money market, insurance and pension companies, real estate etc.
- It forms the core of an economy which facilitates the mobilization and distribution of financial resources.
- It is engaged in providing financial services to the customers of the commercial and retail segments.

Purpose of Financial Sector Reforms

Financial sector reforms are the changes and developments in the Indian financial system. These steps can be for the banks, insurance market, capital market, stock exchanges, etc. These reforms help keep up with the changing financial needs.

- The financial sector consists of all institutions dealing with financial products. They provide financial services to citizens or businesses.
- The financial sector reforms bring changes to this sector. It can be anything from operation guidelines to the entry of foreign entities.
- The financial sector covers banks, insurance businesses, investment funds, NBFCs, etc. These companies can be government-owned or private.
- These entities have regulatory bodies. For example, Indian banks have the RBI. The securities market has SEBI. These bodies are the ones bringing in the reforms.
- They also form rules for their functioning. All companies present in the financial sector must keep up with the changing guidelines.
- The financial sector is responsible for adequate money flow. They allow money from savers to reach borrowers.
- For example, banks and stock exchanges allow people to invest or save money. They further use these deposits to fund companies or individuals.
- It helps in a smooth cash flow where everyone gets what they need. A disruptive financial sector can hamper the entire economy. There would be no or very less economic development. It is due to the absence of credit. People wouldn't have instruments to save or invest. The companies wouldn't have the resources to grow.
- Thus, the financial sector reforms bring modernity and changes. They are per the changing needs.

The financial sector reforms become necessary as the market grows. Indian market is vast. Players are entering different markets from other countries. Flexibility ensures that new businesses can easily operate in the market. It helps in holistic economic development.

Need for Financial Sector Reforms

- After independence India inherited a colonial legacy that was full of various social and economic deprivations.
- The planned economic development strategy adopted based on the Mahalanobis model had its limitations that started showing in the 1980s.
- In order to achieve various economic goals, the government resorted to increased borrowings at concessional rates which lead to weak and underdeveloped financial markets in India.
- The nationalization of banks increased government control and decreased the role of market forces in the financial sector.
- Increased bureaucratic control, issues of red-tapism increased the non-performing assets.
- Turbulent international events such as the war in the Middle East and the fall of the Union of Soviet Socialist Republics (USSR) increased the pressure on the Foreign Exchange Reserves of India.

Narasimham Committee report (1991)

- It was established to give reforms pertaining to the financial sector of India including the capital market and banking sector.
- Some of its major recommendations have been mentioned below:
  - It recommended reducing the cash reserve ratio (CRR) to 10% and the statutory liquidity ratio (SLR) to 25% over the period of time.
  - It suggested fixing at least 10% of the credit for priority sector lending to marginal farmers, small businesses, cottage industries, etc.
  - In order to provide required independence to the banks for setting the interest rates themselves for the customers, it recommended de-regulating the interest rates.

Growth and Development of Indian Financial System At the time of independence in 1947, there was no strong financial institutional mechanism in the country. The industrial sector had no access to the savings of the community. The capital market was primitive and shy. The private and unorganized sector played an important role in the provision of liquidity. On the whole, there were chaos and confusions in the financial system.

After independence, the government adopted mixed economic system. A scheme of planned economic development was evolved in 1951 with a view to achieve the broad economic and

social objective. The government started creating new financial institutions to supply finance both for agricultural and industrial development. It also progressively started nationalizing some important financial institutions so that the flow of finance might be in the right direction. The following developments took place in the Indian financial system:

1. Nationalisation of financial institutions:
2. Establishment of Development Banks:
3. Establishment of Institution for Agricultural Development:
4. Establishment of institution for housing finance:
5. Establishment of Stock Holding Corporation of India (SHCIL):
6. Establishment of mutual funds and venture capital institutions:
7. Major Reforms in IFS (New Economic Policy of 1991)

1. **Nationalisation of financial institutions:** RBI, the leader of the financial system, was established as a private institution in 1935. It was nationalized in 1949. This was followed by the nationalisation of the Imperial bank of India. One of the important mile stone in the economic growth of India was the nationalisation of 245 life insurance Corporation in 1956. As a result, Life Insurance Corporation of India came into existence on 1st September, 1956. Another important development was the nationalisation of 14 major commercial banks in 1969. In 1980, 6 more banks were nationalized. Another landmark was the nationalisation of general insurance business and setting up of General Insurance Corporation in 1972.
2. **Establishment of Development Banks:** Another landmark in the history of development of Indian financial system is the establishment of new financial institutions to supply institutional credit to industries. In 1949, RBI undertook a detailed study to find out the need for specialized institutions. The first development bank was established in 1948. That was Industrial Finance
Corporation of India (IFCI). In 1951, Parliament passed State Financial Corporation Act. Under this Act, State Governments could establish financial corporation's for their respective regions. The Industrial Credit and Investment Corporation of India (ICICI) were set up in 1955. It was supported by Government of India, World Bank etc. The UTI was established in 1964 as a public sector institution to collect the savings of the people and make them available for productive ventures. The Industrial Development Bank of India (IDBI) was established on 1st July 1964 as a wholly owned subsidiary of the RBI.

   On February 16, 1976, the IDBI was delinked from RBI. It became an independent financial institution. It co-ordinates the activities of all other financial institutions. In 1971, the IDBI and LIC jointly set up the Industrial Reconstruction Corporation of India with the

main objective of reconstruction and rehabilitation of sick industrial undertakings. The IRCI was converted into a statutory corporation in March 1985 and renamed as Industrial Reconstruction

Bank of India. Now its new name is Industrial Investment Bank of India (IIBI).

In 1982, the Export-Import Bank of India (EXIM Bank) was set up to provide financial assistance to exporters and importers. On April 2, 1990 the Small Industries Development Bank of India (SIDBI) was set up as a wholly owned subsidiary of IDBI. The SIDBI has taken over the responsibility of administrating the Small Industries Development Fund and the National Equity Fund.

3. **Establishment of Institution for Agricultural Development**: In 1963, the RBI set up the Agricultural Refinance and Development Corporation (ARDC) to provide refinance support to banks to finance major development projects, minor irrigation, farm mechanization, land development etc. In order to meet credit needs of agriculture and rural sector, National Bank for Agriculture and Rural Development (NABARD) was set up in 1982. The main objective of the establishment of NABARD is to extend short term, medium term and long term finance to agriculture and allied activities.
4. **Establishment of institution for housing finance**: The National Housing Bank (NHB) has been set up in July 1988 as an apex institution to mobilize resources for the housing sector and to promote housing finance institutions.
5. **Establishment of Stock Holding Corporation of India (SHCIL)**: In 1987, another institution, namely, Stock Holding Corporation of India Ltd. was set up to strengthen the stock and capital markets in India. Its main objective is to provide quick share transfer facilities, clearing services, support services etc. to investors.
6. **Establishment of mutual funds and venture capital institutions**: Mutual funds refer to the funds raised by financial service companies by pooling the savings of the public and investing them in a diversified portfolio. They provide investment avenues for small investors who cannot participate in the equities of big companies.

   Venture capital is a long term risk capital to finance high technology projects. The IDBI venture capital fund was set up in 1986. The ICICI and the UTI have jointly set up the Technology Development and Information Company of India Ltd. in 1988 to provide venture capital.
7. **Major Reform in IFS (New Economic Policy of 1991)** Indian financial system has undergone massive changes since the announcement of new economic policy in 1991. Liberalisation, Privatisation and Globalisation has transformed Indian economy from closed

to open economy. The corporate industrial sector also has undergone changes due to delicensing of industries, financial sector reforms, capital markets reforms, disinvestment in public sector undertakings etc.

Since 1990s, Government control over financial institutions has diluted in a phased manner. Public or development financial institutions have been converted into companies, allowing them to issue equity/bonds to the public. Government has allowed private sector to enter into banking and insurance sector. Foreign companies were also allowed to enter into insurance sector in India. Major reform in Indian financial sectors

i. Reforms in the Banking Sector

ii. Reforms in the Debt Market

iii. Reforms in the Foreign Exchange Market

i. Reforms in the Banking Sector

- Reduction in CRR and SLR has given banks more financial resources for lending to the agriculture, industry and other sectors of the economy.
- The system of administered interest rate structure has been done away with and RBI no longer decides interest rates on deposits paid by the banks.
- Allowing domestic and international private sector banks to open branches in India, for example, HDFC Bank, ICICI Bank, Bank of America, Citibank, American Express, etc.
- Issues pertaining to non-performing assets were resolved through Lok adalats, civil courts, Tribunals, The Securitisation And Reconstruction of Financial Assets and the Enforcement of Security Interest (SARFAESI) Act.
- The system of selective credit control that had increased the dominance of RBI was removed so that banks can provide greater freedom in giving credit to their customers.

ii. Reforms in the Debt Market

- The 1997 policy of the government that included automatic monetization of the fiscal deficit was removed resulting in the government borrowing money from the market through the auction of government securities.
- Borrowing by the government occurs at market-determined interest rates which have made the government cautious about its fiscal deficits.
- Introduction of treasury bills by the government for 91 days for ensuring liquidity and meeting short-term financial needs and for benchmarking.
- To ensure transparency the government introduced a system of delivery versus payment settlement.

iii. Reforms in the Foreign Exchange Market

- Market-based exchange rates and the current account convertibility was adopted in 1993.
- The government permitted the commercial banks to undertake operations in foreign exchange.
- Participation of newer players allowed in rupee foreign currency swap market to undertake currency swap transactions subject to certain limitations.
- Replacement of foreign exchange regulation act (FERA), 1973 was replaced by the foreign exchange management act (FEMA), 1999 for providing greater freedom to the exchange markets.
- Trading in exchange-traded derivatives contracts was permitted for foreign institutional investors and non-resident Indians subject to certain regulations and limitations.

Impact of Reforms in Indian Financial Sector

- It increased the resilience, stability and growth rate of the Indian economy from around 3.5 % to more than 6% per annum.
- A resilient banking system helped the country deal with the Asian economic crisis of 1977-98 and the Global subprime crisis.
- The emergence of private sector banks and foreign banks increased competition in the banking sector which has improved its efficiency and capability.
- Better performance by stock exchanges of the country and adoption of international best practices.
- Better budget management, fiscal deficit, and public debt condition have improved after the financial sector reforms.