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SCHOOL OF MANAGEMENT STUDIES

UNIT – I – PRINCIPLES AND PRACTICES OF BANKING – SBAA1303

UNIT 1: INTRODUCTION

Introduction - Origin of Banking - Banker A Customer Relationship - General and Special Types of Customers - Origin and Growth Of Commercial Banks In India - Financial Services Offered By Banks - Changing Role Of Commercial Banks - Types Of Banks

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ORIGIN OF BANK

Introduction

- The name bank is derived from the Italian word banco “desk/bench”, used during the Renaissance by Florentine’s bankers. These bankers used to make their transactions above a desk covered by a green tablecloth.
- There are traces of banking activity even in ancient times. In fact, the word traces its origins back to the ancient Roman Empire, where moneylenders would set up their stalls in the middle of enclosed courtyards called macella on a long bench called a bancu.
- It is from here that the words banco and bank are derived.
- A bank is an institution that accepts various types of deposits and then advances money in form of loans to people requiring it. Money and credit provide the pivot (axle) around which all the economic activities revolve.
- Banks are institutions, which accept deposits and use these funds to grant loans. Banks collect the surplus funds of millions of individual savers who are widely scattered.
- To better align the banking system to the needs of planning and economic policy, it was considered necessary to have social control over banks.
- In 1969, 14 of the major private sector banks were nationalized. This was an important milestone in the history of Indian banking.
- To create a strong and competitive banking system, a number of reform measures were initiated in the early 1990s.
- The thrust of the reforms was on increasing operational efficiency, strengthening supervision over banks, creating competitive conditions and developing technological and institutional infrastructure.
- These measures led to the improvement in the financial health, soundness and efficiency of the banking system.

- One important feature of the reforms of the 1990s was that the entry of new private sector banks was permitted. Following this decision, new banks such as ICICI Bank, HDFC Bank, IDBI Bank (public bank) and UTI Bank (now Axis Bank) were set.
- Commercial banks in India have traditionally focused on meeting the short- term financial needs of industry, trade and agriculture.
- However, the increasing diversification of the Indian economy, the range of services extended by commercial banks.

Definition

Under Indian law, Banking Regulation Act of India, 1949, "Accepting, for the purpose of lending or investment, of deposits of money from the public, repayable on demand or otherwise and withdrawal by cheque, draft and order or otherwise" (Section 5b)

Banker and customer relationship

The relationship between a banker and a customer depends on the activities; products or services provided by bank to its customers or availed by the customer. Thus the relationship between a banker and customer is the transactional relationship.

Bank's business depends much on the strong bondage with the customer. "Trust" plays an important role in building healthy relationship between a banker and customer.

Relationships between the Bank and Customer:

The relationship between the banker and customer is very important. It is generally studied under the following two heads

- General Relationship
- Special Relationship

General Relationship:

Debtor and Creditor:

The basic relationship between banker and customer is primarily that of a debtor and creditor. When customer deposits money in a bank, Bank becomes the debtor and customer is the creditor.

The customer expects from the bank that his money will be kept safe by the bank and it will be returned to him on demand within business hours along with interest. The position is reversed as soon as the banker advances loan to the customer, Banker becomes creditor and Customer a debtor.

Special Relationships

Principal and Agent:

Special relationship between the customer and the banker is that of principal and agent. Customer (principal) deposits cheques, drafts, dividends warrants for collection with the bank. Customer also gives written instructions to the bank to purchase securities, pay insurance premium, installments of loans etc on his behalf. When the bank performs such agency services, bank becomes an agent of his customer

Pledger and Pledgee

When the customer pledges (promises) certain assets or securities with the bank in order to get a loan, customer becomes the Pledger, Bank becomes the Pledgee. Under this agreement, the assets or security will remain with the bank until the customer repays the loan

Lessor and Lessee:

When the banker hires a safe deposit locker to the customer, banker becomes the Lessor and customer the Lessee.

Bailer and Bailment relationship:

Bailment is a contract for delivering goods by one party to another to be held in trust for a specific period and returned to him when the purpose is over. Bailor is the party that delivers the goods to another. Bailee is the party to whom the goods are delivered. Example when a customer gives a sealed box to the bank for safe keeping, the customer becomes the Bailor, and the bank the Bailee. A bank may accept the valuables of his customer such as jewellery, documents, securities etc for safe custody. The bank (Bailee) charges a small amount as service charges for safe custody of the valuables from his customer (bailer).

Hypothecator and Hypothecatee:

When the customer hypothecates certain movable property or assets with the banker in order to get a loan, the customer becomes the Hypothecator, and Banker the Hypothecatee.

Trustee and Beneficiary:

A trustee holds property for the beneficiary. The profit earned from this property belongs to the beneficiary. If the customer deposits securities or valuables with the banker for safe custody, banker becomes a trustee of his customer. The customer remains the beneficiary, ownership remains with the customer.

Advisor and Client:

When a customer invests in securities, the banker acts as an advisor. The advice can be given officially or unofficially. While giving advice the banker has to take maximum care and caution. Here, Banker is an Advisor, and Customer is a Client.

Miscellaneous Relationships:

As a Custodian:

A custodian is a person who acts as a caretaker of something. Banks take legal responsibility for a customer's securities. While opening a demat account bank becomes a custodian.

As a Guarantor:

Banks give guarantee on behalf of their customers. Guarantee is a contingent contract. As per Section 31, of Indian Contract Act guarantee is a contingent contract to discharge the liability of the principal debtor if the later fails to do so.

Special Types of Customers

By opening an account the banker enters into a contractual relationship with the customer. Every person who is competent to contract can open an account with a bank. The capacity of certain classes of person, to make valid agreement is subject to certain legal restrictions.

Minor: A person under the age of 18 years is a minor. If a court appoints a guardian and the minor is below 18 years the minority is extended up to 21 years.

A minor’s savings bank account may be opened in any of the following ways:

i. In the name of minor himself: This account will be operated by the minor alone. In his personal presence (in the bank) he can withdraw the money from his account.
ii. In the joint names of the minor and his/her guardian: This account will be operated jointly by minor and his/her guardian.
iii. In the name of guardian: This account will be operated by the guardian on behalf of the minor.

Lunatic

Under Indian ContractAct, a contract with a lunatic is void. The reason being that the lunatic being of unsound mind is not competent to comprehend the meaning of a contract. If the banker without knowing that the person is lunatic opens an account and enters into contract acting in good faith he is protected. But when once he gets a notice of lunacy of a person, he should not enter into any contract.

Drunkard:

Under section 12 of Indian Contract Act 1872, a man who is drunk cannot understand the contract, or form rational judgment. He cannot enter into contract while such delirium or drunkenness lasts. When a customer who is drunk presents a cheque across a counter the payment must be witnessed

Married Woman:

A married woman can enter into a contract and bind her personal (separate) assets. Bank should observe extra precautions regarding sanction of overdraft / loan to a married woman because it will have no remedy against her if she does not have any personal assets. Her husband will not be liable for any debt of his wife except in the following cases: Where the loan is taken with his consent or where she acts as the agent of her husband. Where the loan has been taken for the purchase of necessities which the husband has failed to provide

Illiterate persons:

An illiterate person means a person who can’t sign his name. While opening of an account of such a person is unavoidable, the banker should obtain:

- Left thumb impression on the account opening form and specimen signature card in the presence of an authorized bank official.
- Detailsofidentificationmarksshouldbenotedontheaccountopeningformandspec imensignature card.
- At least two copies of photograph duly attested by any account holder/authorized bank official.
- Except his physical presence (in the bank), any withdrawals from the account of an illiterate person will not be allowed.

Partnership Firm:

Section 4 of the Indian Partnership Act 1932, defines partnership as a relationship subsisting between persons who have agreed to share the profits of a business carried on by all or any of them acting for all. While opening an account the partnership letter should be signed by all the partners.

The purpose of the business, address, names of the partners and other details should be clearly obtained. The partnership letter and the deed should contain instructions pertaining to opening a bank account and its operation.

Company Account:

Company is a legal entity. The formation of a company is governed by Companies Act 2013.

While opening an account in a company's name the banker has to ask for:

- Certified copies of Memorandum and Articles of Association and Certificate of Incorporation.
- Names of the directors
- Certificate of commencement of business.
- Copy of resolution appointing the bank as Company's Bank. And the names of the persons who are authorized to operate the account along with their signatures.

- Death of authorized signatories does not require the stopping of payments since the company remains in existence.

Trust Account's:

- According to Indian Trust Act 1882, trust is an obligation annexed to the ownership of a property, arising out of confidence reposed in and accepted by the person for the benefit of another person.

- The person who reposes and declares confidence is called the author of the trust. The person in whom confidence is reposed is called the trustee. The person for whose benefit the confidence is reposed is a beneficiary. The instrument by which the trust is created is the trust deed. Bank has to study the trust deed as regards to the opening and operations of the account. Bank should ensure that money is received and used as per the Trust Deed.

Hindu Undivided Family (HUF):

Where a Hindu dies leaving a business, the business is passed onto the hands ofhis legal heirs. It becomes HUF property. The members of the family are called Coparceners and eldest member becomes the manager or the Karta of the HUF. The Karta has the implied authority to avail loan and execute necessary documents. It binds all the members. The other members of the family are also required to sign the documents as a precautionary measure even though legally theyare bound bythe actions of the Karta. If there is no male member, the daughter can also become a Karta.

Joint Account Holders:

- Joint account means account of two or more persons who are not partners. A banker should keep in view the following provisions while opening and operating joint accounts:

The account should be opened only on receiving an application signed by all the persons interested in opening the account. A mandate signed by all the parties containing clear instructions as to how the account is to be operated should be obtained. Specimen signature card should be signed by all the account holders.

In absence of "either or survivor" instruction the balance will be payable to all the joint account holders including legal representative/heirs of the deceased but in case of "either or survivor" instruction the balance will be payable to the survivor (s).It is wise to stop the operation of a joint account after the death of anyone of the joint account holders and a new account be opened in the name of surviving account holder(s).

Executors and Administrators:

An executor should submit a probate, and an administrator should submit the "letter of administration" to the bank as a proof of his authority to operate the account of a deceased person.The banker should thoroughly examine the probate/letter of administration to acquaint himself with the powers and functions of executors/ administrators.

An account may be opened in the name of executor/administrator in the following style: ABC executors (or Administrators) of the estate of X, the deceased. Incase of joint executor/administrator mandate signed by all of them should be obtained regarding the operation of the account.

The insolvency or lunacy of the executor/administrator will terminate his authority to operate the account (unless it has been overdrawn).

Societies and other non- trading institutions:

The society, may sum a club, school, hospital or any institution. It must be registered as a corporate body. Following procedures is to be followed by a banker:

- Copies of Memorandum, Articles of Association of the society must be obtained to acquaint with its broad objectives, rules & by-laws for adult certified copy of the resolution passed by the managing committee of the society authorizing the bank to open the society's account.
- The resolution should also state the name (s) of persons authorized to operate the account.
- If the person authorized to operate the account of the society has his personal account in the bank the banker should exercise precaution that the society's money does not find its way into the personal account of the office bearer.

Origin and growth of commercial bank in India

- The commercial banking industry in India started in 1786 with the establishment of the Bank of Bengal in Calcutta.
- British India at the time established three Presidency banks, namely,

1. Bank of Bengal (established in 1809)

2. Bank of Bombay (established in 1840)

3. Bank of Madras (established in 1843

- In 1921, the three Presidency banks were amalgamated to form the Imperial Bank of India, which took up the role of a commercial bank, a bankers' bank and a banker to the Government.
- The Imperial Bank of India was established mainly with European shareholders. After the establishment of the Reserve Bank of India (RBI) as the central bank of the country in 1935, the role of the Imperial Bank of India came to an end.
- 1865, the Allahabad Bank was established purely by Indian shareholders. Punjab National Bank came into being in 1895. Between 1906 and 1913, other banks like Bank of India, Central Bank of India, Bank of Baroda, Canara Bank, Indian Bank, and Bank of Mysore were set up.
- After independence, the Government of India started taking steps to encourage the spread of banking in India.
- In order to serve the economy in general and the rural sector in particular the All India Rural Credit Survey Committee recommended the creation of a state-partnered and state-sponsored bank taking over the Imperial Bank of India and integrating with it,
- the former state-owned and state associate banks. India.
- Accordingly, State Bank of India (SBI) was constituted in 1955. Subsequently, in 1959, the State Bank of India (subsidiary bank) Act was passed, enabling the SBI to take over eight former state-associate banks as its subsidiaries

Financial services offered by banks

- Fee based Banking Products/ Services Broadly fee-based services can be divided two categories:
- 1. Corporate fee-based services 2. Retail fee-based services

Retail fee-based services

- Personal Tax Counseling One of the emerging areas of Income TaxAct1961, every individual whose annual taxable income exceeds the specified limit should pay income tax and file the annual return in a prescribed format.
- These limits are revised periodically at the time of presentation of annual budget by the Union Finance Minister and given effect by an amendment to the Finance Act.

Credit Cards A Credit Card is a plastic card bearing an account number assigned to a cardholder with a credit limit that can be used to purchase goods and services

Debit Cards Debit card act as ATM card

Smart Cards Smart Cards offer consumers the ability to hold multiple applications on a single card, separately and securely. Smart cards allow consumers to make secure electronic commerce purchases anytime, anywhere they go.

E-Cash is a payment system, based on smart card technology, which offers an alternative to paying cash for goods and services.

Automated Teller Machines (ATM)) An Automated Teller Matching is a mechanism which enables the customer to withdraw money from his account without visiting the bank branch

Foreign Inward/Outward Remittances

- Non-resident Indians working abroad may have to send money to their near and dear in India.
- Companies and business firms also may have to send remittances to India in connection with their business.
- Exporters receive advance remittances in respect of the export order received from aboard.

Fund Transfer Facilities

- Predominantly, people were using post offices for funds transfer.

- The development of banking enabled the banks to provide fund transfer facilities at a cheaper rate than the money order facility offered by postal department.Online Trading

Online trading involve trading in shares, debentures, commodities, and foreign exchange in the respective markets.

Portfolio Management Banks NBFCs and broking firm are providing portfolio management services to individuals.

Safe Deposit Lockers

Safe deposit locker is a facility provided by banks to their customers to keep their valuables like jewelry, title deeds, etc. Microfinance
Microfinance refers to a range of financial services including credit, savings, insurance, money transfers, and other financial products provided by different service provides, targeted at poor and low-income people

Corporate fee-based services

A corporate fee based service is a collective term giving to all those financial services that various financial institutions, bank offer to corporate customers on payment of a fee. The various fee-based services provided by banks to corporate customers are: Cash Management Services Cash management is the effective management of cash in order to minimize transaction costs, exercise greater control and maximize returns.
Collection: Collection and disbursement of cheques for the clients form an important part of the cash management services. Clients continuously receive payments from their distributers and customers in the form of cheques and demand drafts

Payment: Payment services include payments to clients'vendors and suppliers, dividends to the shareholders payment of interest on commercial bills and
debentures payment of salaries to employees, etc.

Liquidity : Liquidity management involves pooling and distributing funds across the client's multiple accounts with the bank.

Merchant Banking Merchant Banking can be defined as an activity in which a bank deals mostly in international finance, long-term loans for companies and underwriting. They include registrar service, underwriting services and custodial services.

Foreign Exchange Services Foreign exchange services refer to converting foreign currency into Indian currency and vice-versa.

Bill Discounting This product enables corporate to fund their operating cycle right from the stage of procurement to sale.

Leasing Lease is contract between the owner of the asset and the user of the asset called the lessee

Letter of Credit Under the system of letter of credit the banker issues commitment on behalf of its client to the supplier of goods to accept clients' bills up to the amount stated in the letter of credit.

Forfeiting is a form of financing of receivables pertaining to international trade. It denotes the purchase of trade bills / Promissory notes by a bank / financial institution without recourse to the seller.

Types of Banks

- There are various types of banks which operate in our country to meet the financial requirements of different categories of people engaged in agriculture, business, profession, etc. On the basis of functions, the banking institutions in India may be divided into the following

Types of Banks

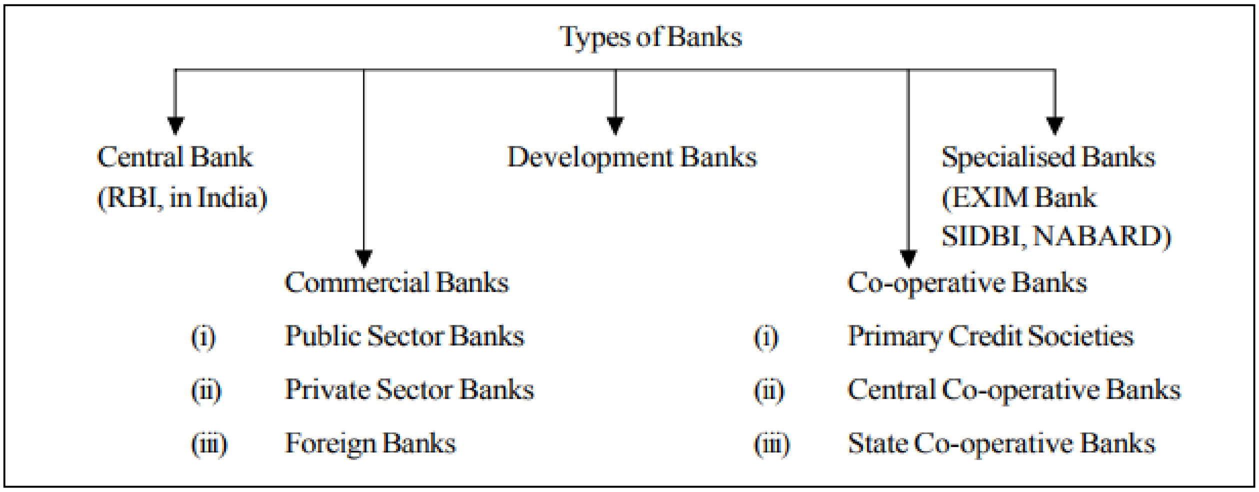

Fig 1

Commercial Banks

Commercial Banks are banking institutions that accept deposits and grant short- term loans and advances to their customers. In addition to giving short-term loans, commercial banks also give medium-term and long-term loan to business enterprises.

- Now-a-days some of the commercial banks are also providing housing loan on a long-term basis to individuals

Public Sector Banks:

These are banks where majority stake is held by the Government of India or Reserve Bank of India.

Examples of public sector banks are:

State Bank of India, Corporation Bank, Bank of Boroda and Dena Bank, etc.

Private Sectors Banks:

- In case of private sector banks majority of share capital of the bank is held by private individuals. These banks are registered as companies with limited liability.
- For example: The Jammu and Kashmir Bank Ltd., Bank of Rajasthan Ltd., Development Credit Bank Ltd, Lord Krishna Bank Ltd., Bharat Overseas Bank Ltd., Global Trust Bank, Vysya Bank, etc.

Foreign Banks:

- These banks are registered and have their headquarters in a foreign country but operate their branches in our country.
- Some of the foreign banks operating in our country are Hong Kong and Shanghai Banking Corporation (HSBC), Citibank,American Express Bank, Standard & Chartered Bank, Grindlay's Bank, etc.
- The number of foreign banks operating in our country has increased since the financial sector reforms of 1991.

Development Banks

Business often requires medium and long-term capital for purchase of machinery and equipment, for using latest technology, or for expansion and modernization. Such financial assistance is provided by Development Banks.

They also undertake other development measures like subscribing to the shares and debentures issued by companies, in case of under subscription of the issue by the public.

Industrial Finance Corporation of India (IFCI) and State Financial Corporations (SFCs) are examples of development banks in India

Co-operative Banks

- People who come together to jointly serve their common interest often form a co-operative society under the Co-operative Societies Act.
- When a co-operative society engages itself in banking business it is called a Co-operative Bank.
- The society has to obtain a license from the Reserve Bank of India before starting banking business.
- Any co-operative bank as a society is to function under the overall supervision of the Registrar, Co-operative Societies of the State.
- As regards banking business, the society must follow the guidelines set and issued by the Reserve Bank of India

Primary Credit Societies:

- These are formed at the village or town level with borrower and non- borrower members residing in one locality.
- The operations of each society are restricted to a small area so that the members know each other and are able to watch over the activities of all members to prevent frauds.

Central Co-operative Banks:

- These banks operate at the district level having some of the primary credit societies belonging to the same district as their members.
- These banks provide loans to their members (i.e., primary credit societies) and function as a link between the primary credit societies and state co- operative banks.

State Co-operative Banks:

- These are the apex (highest level) co-operative banks in all the states of the country.
- They mobilize funds and help in its proper channelization among various sectors.
- The money reaches the individual borrowers from the state co-operative banks through the central co-operative banks and the primary credit societies.

Specialized Banks

- There are some banks, which cater to the requirements and provide overall support for setting up business in specific areas of activity.
- EXIM Bank, SIDBI and NABARD are examples of such banks. They engage themselves in some specific area or activity and thus, are called specialized banks.
- Export Import Bank of India (EXIM Bank): If you want to set up a business for exporting products abroad or importing products from foreign countries for sale in our country,
- EXIM bank can provide you the required support and assistance. The bank grants loans to exporters and importers and also provides information about the international market. It gives guidance about the opportunities for export or import, the risks involved in it and the competition to be faced, etc.

Small Industries Development Bank of India (SIDBI):

- ✓ To establish a small-scale business unit or industry, loan on easy terms can be available through SIDBI.
- ✓ It also finances modernization of small-scale industrial units, use of new technology and market activities.
- ➢ The aim and focus of SIDBI is to promote, finance and develop small-scale industries

National Bank for Agricultural and Rural Development (NABARD)

- ➢ It is a central or apex institution for financing agricultural and rural sectors.
- ➢ If a person is engaged in agriculture or other activities like handloom weaving, fishing, etc.
- ➢ NABARD can provide credit, both short-term and long-term, through regional rural banks.
- ➢ It provides financial assistance, especially, to co-operative credit, in the field of agriculture, small-scale industries, cottage and village industries handicrafts and allied economic activities in rural.

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SCHOOL OF MANAGEMENT STUDIES

UNIT – II – PRINCIPLES AND PRACTICES OF BANKING – SBAA1303

UNIT 2: DEPOSITS

Banker – Customer Relations - Different Deposit Products - Mandate and Power of Attorney - Banker's Lien – Right off Set off - Payment and Collection of Cheques - Duties and Responsibilities of Paying and Collecting Banker - Protection available to Paying and - Collecting Banker under NI Act – Endorsements - Forged Instruments - Bouncing of Cheques and their implications

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INTRODUCTION

The relationship between a banker and his customer depends upon the nature of service provided by a banker. Accepting deposits and lending and/or investing are the core banking businesses of a bank. In addition to its primary functions, it deals with various customers by providing other services like safe custody services, safe deposit lockers, and assisting the clients by collecting their cheques and other instruments as an agent and trustees for them. So, based on the above a banker customer relationship can be classified as under: Debtor/Creditor Creditor/Debtor Bailee/Bailer Lesser/Lessee Agent/Principal.

MEANING OF A BANKING COMPANY

A banking company is defined as a company which transacts the business of banking in India . Section 5 (b) of The Banking RegulationAct, 1949 defines the term banking as "accepting for the purpose of lending or investment of deposits of money from the public, repayable on demand or otherwise and withdrawable by cheque, draft, order or otherwise. Section -7 of this Act makes it essential for every company carrying on the business of banking in India to use as part of its name at least one of the words – bank, banker, banking or banking company.

Features of Banking

The following are the basic characteristics to capture the essential features of Banking:

(i) Dealing in money: The banks accept deposits from the public and advance the same as loans to the needy people. The deposits may be of different types - current, fixed, savings, etc. accounts. The deposits are accepted on various terms and conditions.

(ii) Deposits must be withdrawable: The deposits (other than fixed deposits) made by the public can be withdrawable by cheques, draft or otherwise, i.e., the bank issue and pay cheques. The deposits are usually withdrawable on demand.

iii) Dealing with credit: The banks are the institutions that can create credit i.e., creation of additional money for lending. Thus, "creation of credit" is the unique feature of banking

(iv) Commercial in nature: Since all the banking functions are carried on with the aim of making profit, it is regarded as a commercial institution.

(v) Nature of agent: Besides the basic function of accepting deposits and lending money as loans, bank possesses the character of an agent because of its various agency services.

WHO IS A CUSTOMER?

The term 'customer' of a bank is not defined by law. Ordinarily, a person who has an account in a bank is considered is customer. Banking experts and the legal judgments in the past, however, used to qualify this statement by laying emphasis on the period for which such account had actually been maintained with the bank.

For the purpose of KYC policy, a 'Customer' is defined as : –

A person or entity that maintains an account and/or has a business relationship with the bank; – one on whose behalf the account is maintained (i.e. the beneficial owner); –

Beneficiaries of transactions conducted by professional intermediaries, such as Stock Brokers, Chartered Accountants, Solicitors etc. as permitted under the law,

and – any person or entity connected with a financial transaction which can pose significant reputational or other risks to the bank, say, a wire transfer or issue of a high value demand draft as a single transaction.

BANKER CUSTOMER RELATIONSHIP

Relationships between the Bank and Customer: The relationship between the banker and customer is very important. It is generally studied under the following two heads

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Debtor and Creditor:

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- When customer deposits money in a bank, Bank becomes the debtor and customer is the creditor.
- The customer expects from the bank that his money will be kept safe by the bank and it will be returned to him on demand within business hours along with interest.
- The position is reversed as soon as the banker advances loan to the customer, Banker becomes creditor and Customer a debtor.

Special Relationships

Trustee - beneficiary:

- The customer deposits securities and valuables for safe custody with the banker.
- The banker in such a case is a trustee and so, whenever the customer demands the security, the banker has to return them to the customer who is the beneficiary.
- A trustee holds property for the beneficiary. The profit earned from this property belongs to the beneficiary.
- The customer remains the beneficiary, ownership remains with the customer.
- The banker is also a trustee whenever he undertakes to collect cheques given for collection.
- Once the cheques are released, the banker is a trustee and the customer is a beneficiary.

Principal and Agent:

- Special relationship between the customer and the banker is that of principal and agent.

- Customer (principal) deposits cheques, drafts, dividends warrants for collection with the bank.
- Customer also gives written instructions to the bank to purchase securities, pay insurance premium, installments of loans etc. on his behalf.
- When the bank performs such agency services, bank becomes an agent of his customer

Pledger and Pledgee

- When the customer pledges (promises) certain assets or securities with the bank in order to get a loan, customer becomes the Pledger,
- Bank becomes the Pledgee. Under this agreement, the assets or security will remain with the bank until the customer repays the loan

Lessor and Lessee: When the banker hires a safe deposit locker to the customer, banker becomes the Lessor and customer the Lessee.

Bailer and Bailment relationship:

Bailment is a contract for delivering goods by one party to another to be held in trust for a specific period and returned to him when the purpose is over.

Bailor is the party that delivers the goods to another. Bailee is the party to whom the goods are delivered.

Example when a customer gives a sealed box to the bank for safe keeping, the customer becomes the Bailor, and the bank the Bailee.

A bank may accept the valuables of his customer such as jewellery, documents, securities etc. for safe custody.

The bank (Bailee) charges a small amount as service charges for safe custody of the valuables from his customer (bailer).

Hypothecator and Hypothecatee:

When the customer hypothecates certain movable property or assets with the banker in order to get a loan, the customer becomes the Hypothecator, and Banker the Hypothecatee.

The possession of the asset remains with the lender in case of a pledge; while it remains with the borrower in case of hypothecation.

Common examples include the gold loan in case of pledge and vehicle loan in case of hypothecation.

Advisor and Client:

When a customer invests in securities, the banker acts as an advisor.

The advice can be given officially or unofficially.

While giving advice the banker has to take maximum care and caution. Here, Banker is an Advisor, and Customer is a Client.

Miscellaneous Relationships:

As a Custodian:

- A custodian is a person who acts as a caretaker of something.
- Banks take legal responsibility for a customer's securities.
- While opening a demat account bank becomes a custodian.

As a Guarantor:

- Banks give guarantee on behalf of their customers. Guarantee is a contingent contract.
- As per Section 31, of Indian Contract Act guarantee is a contingent contract to discharge the liability of the principal debtor if the later fails to do so.

MANDATE AND POWER OF ATTORNEY

The mandate and power attorney are the rights cast upon a third person to act on behalf of the principal person/s. The rights of mandate and power of attorney holders are very similar in the operation of bank accounts but they are issued for different reasons and purposes

MANDATE

A mandate, is a simple letter of authority, signed by a constituent authorising the bank to permit a certain named person (agent) to operate the account on his/her behalf. A mandate to operate an account does not extend to overdrawing the account unless the mandate letter specifically provides the authority to overdraw the account. In the case of Joint accounts, all the depositors to the account must sign the mandate letter. In the case of partnership firms, all the partners of the firm must sign the mandate letter. One of the joint account holders or any partner of the firm as the case may be can revoke this authority by writing to the bank.In the case of H.U.F, the mandate must be signed by the Karta and all the major co-parceners. In case the mandate is to be issued in favour of a third party an Indemnity has to be executed by the Karta and major co-parceners of the H.U.F.

Power of Attorney

A power of attorney (POA) is a legal document giving one person (the agent or attorney-in-fact) the power to act for another person (the principal). The agent can have broad legal authority or limited authority to make legal decisions about the principal's property, finances or medical care. The power of attorney is frequently used in the event of a principal's illness or disability, or when the principal can't be present to sign necessary legal documents for financial transactions.

General Power of Attorney. In this situation, the agent can perform almost any act as the principal, such as opening financial accounts and managing personal finances. A general power of attorney arrangement is terminated when the principal becomes incapacitated, revokes the power of attorney or passes away.

Durable Power of Attorney. This arrangement designates another person to act on the principal’s behalf and includes a durable clause that maintains the power of attorney after the principal becomes incapacitated.

Special or Limited Power of Attorney. In this instance, the agent has specific powers limited to a certain area. An example is a power of attorney that grants the agent authority to sell a home or other piece of real estate.

Springing Durable Power of Attorney. In some states, a “springing” power of attorney is available and becomes effective when a specified event occurs such as when the principal becomes incapacitated.

Obligations of Banker

The relationship between the banker and customers creates some obligations on the part of a bank. The fundamental obligations of a banker towards it’s customers are as follows:

1. Obligation of Banker to Honour Cheques

The bank has a statutory obligation to honour the cheques of its customers up to the amount standing to the credit of the customer’s account. If a bank wrongfully refuses to honour the cheque of its customer, the bank shall be liable to compensate the customer. This obligation is subject to some conditions, namely:

a) There must be sufficient funds of the customer in the hands of the bank.
b) The funds must be properly applicable for the payment of the customer’s cheque.
c) The cheque must be properly drawn up i.e., it should be complete in all respects.
d) The cheque must be presented for payment within a reasonable time(within 90 days from the date of issue).
e) There must be no legal bar preventing the payment of such cheques. If the bank has received any order from a court or any other competent authority prohibiting payment, it is the duty of the bank to obey such orders.

2. Obligation of banker to Maintain Secrecy

The banker must not disclose to any outsider the details about the customer’s account; as such disclosures may adversely affect the credit and business of the customer. However, a disclosure can be made under the following two situations:

(a) When the law requires such disclosures to be made, and

(b) when the practices amongst the banks permit such disclosure.

3. Obligation of Banker to Maintain Proper Records

The banker is under an obligation to maintain accurate record of all the transactions (credits and debits) of the customers made with the bank.

4. Obligation of Banker to Follow Customer's Instructions

The banker is under a legal obligation to follow the instructions of the customer. This is so because there is the contractual relationship between the bank and the customer.

5. Obligation of Banker to give Notice before Closing the Account

If a banker wishes to close the account of a customer, it must give a reasonable notice to this effect to the customer.

Thus, a bank cannot close the account of a customer on its own wish, because it may have serious consequences to the customer.

Rights of Banker

For fulfilling the obligations towards the customers, bankers enjoy some rights. The following are the rights available to a Banker:

1. Right of General Lien

One of the most important rights enjoyed by a bank is the right of general lien. Lien is a right of a person to retain goods belonging to another; until the demands of the person in possession are satisfied. Section 171 of the Indian Contract Act confers the right of general lien on the bankers. General lien entitles the banker in possession to retain goods and securities till all its claims against the customer are satisfied. You should note that the banker can exercise his right of general lien only as a banker and not as a bailee, Banker's lien is an implied pledge in the sense that if a default is made by the debtor, the banker can, after giving a reasonable notice to the customer, sell the goods in his possession and recover the amount. If some valuables are deposited with a bank for safe custody, then it is bailment and the bank cannot exercise the right of general lien.

You should note that the right of general lien cannot be exercised in the following cases:

a) When valuables are deposited for safe custody,

b) When money or documents are deposited for a specific purpose,

c) When some securities are left with the bank by mistake,

d) When the property is held by the customer as trustee and the bank has the notice of trust, and

e) When there is an express agreement that the bank shall not exercise the right of general lien.

2. The Right of Set-off

Right of set-off is the right of a debtor to adjust the amount due to him from a creditor against the amount payable by him to the creditor to determine the net balance payable by one to another, Like any other debtor, a bank also has a right of set- off. When a customer has two or more accounts in the same name and capacity in a bank, the bank has the right to adjust the amount standing to the credit of the customer against the debit balance in the other account. The bank has a right to combine the two accounts.

Let's take an example: Mr Ram has overdrawn his current account to the extent of Rs. 1,00,000 and he has a credit balance of Rs.80,000 in his savings account. The bank can combine these two accounts and claim the balance of Rs.20,000 after adjusting the credit balance of savings account against the debit balance of current account,

3. Right of Appropriation

A customer may owe several distinct debts to the bank. When the customer deposits some money in the bank without specific instructions and the amount is not sufficient to discharge all debts, then the problem arises as towards which debt this amount should be adjusted. In the absence of any specific instructions, the bank has the right to appropriate the deposited amount to any loan, even to a time barred debt. But the banker must inform the customer about the appropriation.

4. Right to Charge Interest and Commission

The bank has the implied right to charge interest on loans and advances, and also to charge commission for services rendered by the bank, such as SMS notification service, retail banking, multi city cheque service etc. The bank can debit such charges to the customer's account.

5. Right to Close the Account

If the bank is of the opinion that an account is not being operated properly, it may close the account by sending a written intimation to the customer. But the notice is mandatory, without sending such notice a banker can not close any customer's account.

Termination of Banker – Customer Relationship

The relationship between banker and customer terminates in the following grounds

a. Voluntary termination.

b. Death of the customer

c. Bankruptcy of the customer

d. Liquidation of the company

e. Insanity of the customer

DUTIES AND RESPONSIBILITIES OF PAYING AND COLLECTING BANKER

A banker on whom the cheque is drawn should pay the cheque, when it is presented for payment. It is his obligation by section 31 of the NI Act. A banker is bound to honour his customers cheque to the extent of the fund available & the existence of no legal bar for payment. The paying banker should use reasonable care and diligence in paying a cheque so as to abstain from any action likely to damage his customers' credit.

In other words, it is the obligation of the bank to honour the cheques issued by the customer if the following conditions are fulfilled:

(a) There is sufficient balance in the account of the customer;

(b) The cheque is properly drawn and presented; and

(c) There is no legal restriction on payment.

The banker who is liable to pay the value of a cheque of a customer as per the contract, when the amount is due from him to the customer is called “Paying Banker” or “Drawee Bank.” The payment to be made by him has arisen due to the contractual obligation. He is also called drawee bank as the cheque is drawn on him.

At the time of making payment of he should observe the following very carefully:

i. Verification of signature of the drawer.

ii. Verification of the genuineness of the instrument.

iii. Payment not stopped by the A/c holder.

iv. Holders title on the cheque is valid.

v. A/c is not dormant one.

vi. A/c holder is not bankrupt, deceased and insanse.

vii. A/c is not under subject of liquidation process.

viii. No. ‘Garnishee Order’ is issued by count.

ix. Properly endorsed.

x. Cheque is not drawn beyond limit fixed by the drawer is respect of amount.

xi. Instrument being presented is crossed.

xii. Instrument is not state or post dated.

xiii. No material alteration is made.

xiv. Sufficient balance in the A/c

- Collecting Banker: A Collecting Banker is one who undertakes to collect various 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 and some are quasi negotiable instruments.

Duties & Responsibilities of Collecting Bankers:

- Acting as agent: While collecting an instrument, whether for credit to customer's account or for himself, the Bankers works as agent of his customer. As an agent he has generally to take such steps & precautions to protect the interest or his customer as a man of ordinary prudence would take to safe-guard his own interest.

- Scrutinizing the instruments: Name of the holder, Branch name, date, amount in world and figure, any cutting without signature, material alteration of any to be checked carefully.

- Checking the endorsement: Bankers has to check the instrument whether it has been endorsed properly.

- 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.

- Collecting the proceeds in the payee's account: It is the duty of collecting banks to collect and credit the proceed of the instruments to the proper/correct account.

- Notice of dishonor and returning the instruments: If any instrument is dishonored by the paying bank it should be informed to the customer on the business day following the receipt of the unpaid instruments.

Collecting Banker's Protection:

Under section 131 of negotiable instrument Act the collecting banker is not liable to the true owner of a cheque or a banker's draft if his title to the instrument proves defective provided the cheque or draft was one crossed generally or specially to himself and collected for a customer is good faith and without negligence.

The above statutory protection is available to the collecting banker only if he fulfills the following conditions:

i. The cheque he collected is a crossed cheque.

ii. He collected such crossed cheque only for his customer as an agent & not as a holder for value.

iii. He collected such crossed cheque in good faith and without negligence.

<u>No Protection:</u>

- Opening of A/c without satisfactory references/ introduction.
- Crediting the proceeds of cheque to an endorsee with irregular endorsement.
- Crediting the proceed of a cheque to the personal A/c of director, partners or any employee when it is payable to the company.
- Crediting the proceeds of charge to personal name of the official when it is payable to a govt. agency, autonomous body, or corporation.
- Crediting the amount of a cheque in the personal A/c which is drawn by an agent on behalf of its principal.
- When the customer depositing the cheque is of little means and the cheque deposited suddenly is of sizable amount and the banker credited the proceeds there to without making proper enquiry.
- Cheque drawn by customer is dishonored very often and crediting such account with the proceeds of collecting cheque without making proper enquiry.

- If the crossed cheque is collected and credited the proceed to the other account.

ENDORSEMENT

An endorsement may be a signature authorizing the legal transfer of a negotiable instrument between parties. Endorsements can also be amendments to contracts or documents, such as life insurance policies or driver's licenses. The act of a person who is a holder of a negotiable instrument in signing his or her name on the back of that instrument, thereby transferring title or ownership is an endorsement. An endorsement may be in favour of another individual or legal entity. An endorsement provides a transfer of the property to that other individual or legal entity. The person to whom the instrument is endorsed is called the endorsee. The person making the endorsement is the endorser. Let us discuss the Endorsement of Instruments here in detail.

Types of Endorsement

1. Blank Endorsement or General Endorsement

An endorsement is blank or general where the endorser signs his name only, and it becomes payable to bearer. Thus, where a bill is payable to "Ram or order", and he writes on its back "Ram", it is an endorsement in blank by Ram and the property in the bill can pass by a mere presentation.

We can convert a blank endorsement into an endorsement in full. We can do so by writing above the endorser's signature, a direction to pay the instrument to another person or his order.

2. Special or Full Endorsement

An endorsement "in full" or a special endorsement is one where the endorser puts his signature on the instrument as well as writes the name of a person to whom order the payment is to be made.

A bill made payable to Ram or order, and endorsed "pay to the order of Shyam" would be specially endorsed and Shyam endorses it further. We can turn a blank endorsement into a special one by adding an order making the bill payable to the transferee

3.Conditional Endorsement: Where an endorsement is made with a specific condition to be fulfilled by the endorsee for acquiring the ownership right on the instrument ,it is conditional endorsement.

Example: Pay to Raman on delivery of Bill of lading

-(Sd)Krishnan

4. Restrictive Endorsement

An endorsement is restrictive which restricts the further negotiation of an instrument.

Example of restrictive endorsement: "Pay to Mrs. Geeta only" or "Pay to Mrs Geeta for my use" or "Pay to Mrs Geeta on account of Reeta" or "Pay to Mrs. Geeta or order for collection".

5. Partial Endorsement

An endorsement partial is one which allows transferring to the endorsee a part only of the amount payable on the instrument. This does not operate as a negotiation of the instrument.

Example: Mr. Mohan holds a bill for Rs. 5,000 and endorses it as "Pay Sohan or order Rs. 2500". The endorsement is partial and invalid.

6.Sans – recourse endorsement:

When the endorser informs the endorsee that in case of the dishonor of the instrument, the endorsee cannot make the endorser liable.

The endorsee can only catch hold of any other party on the instrument but not the endorser. Example: Pay to Raman Sans – recourse

-(Sd Krishnan)

7.Sans – frais endorsement:

When the endorser informs the endorsee thatany expense incurred in receiving payment on the instrument should not be debited to the account of the endorsder.

8.Facultative endorsement:

When the endorser excuses the endorsee from performing any duty incase of dishonor. Example: Pay to Raman.

Notice of dishonor waived

-(Sd Krishnan).

From this endorser does not escape his liability incase of dishonor of the instrument.

(Sd) refers to signed by

FORGED INSTRUMENTS

A FORGED INSTRUMENT means a written instrument which has been falsely made, completed or altered. The words "written instrument," "falsely made," "falsely completed," and "falsely altered" used in the definition of "forged instrument" also have their own special meanings.

An individual may be charged with criminal possession of a forged instrument if they are holding or using a type of document or instrument that meets the definition in the law, knows that the instruments have been forged, and has the intention to defraud. Examples of forged instruments include: Checks. Credit Cards.Mar 3, 2017

BOUNCING OF CHEQUE AND THEIR IMPLICATIONS

According to Section 138 of the Act, the dishonour of cheque is a criminal offence and is punishable by imprisonment up to two years or with monetary penalty or with both. If payee decides to proceed legally, then the drawer should be given a chance of repaying the cheque amount immediately.

Legal action

The Negotiable Instruments Act, 1881 is applicable for the cases of dishonour of cheque. This Act has been amended many times since 1881.

According to Section 138 of the Act, the dishonour of cheque is a criminal offence and is punishable by imprisonment up to two years or with monetary penalty or with both.

If payee decides to proceed legally, then the drawer should be given a chance of repaying the cheque amount immediately. Such a chance has to be given only in the form of notice in writing.

The payee has to sent the notice to the drawer with 30 days from the date of receiving "Cheque Return Memo" from the bank. The notice should mention that the cheque amount has to be paid to the payee within 15 days from the date of receipt of the notice by the drawer. If the cheque issuer fails to make a fresh payment within 30 days of receiving the notice, the payee has the right to file a criminal complaint under Section 138 of the Negotiable Instruments Act.

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SCHOOL OF MANAGEMENT STUDIES

UNIT – III -PRINCIPLES AND PRACTICES OF BANKING – SBAA1303

UNIT 3: BANK LENDING

Principles of Lending - Various Credit Products/Facilities - Working capital and Term Loans - Credit Appraisal Techniques - Approach to lending - Credit Management - Credit Monitoring - NPA Management - Priority Sector Lending - Factoring - Ancillary Services – Remittances - Safe Deposit Lockers

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INTRODUCTION

- ✓ A bank is a financial institution that accepts deposits and channels those deposits into lending activities
- ✓ It is done either directly by lending to the needy borrowers or indirectly by investing in the capital market instruments

Bank lending is relevant to all sectors in the economy

- ✓ Primary sector - Includes agriculture, mining and fishing
- ✓ Secondary sector - Includes various industries
- ✓ Service sector - Includes retail, tourism, banking, entertainment and I.T. services.

In this process bank involves:

- ✓ Commercial bank which mainly grants short term credit facilities. Eg: State Bank of India, Punjab National Bank
- ✓ Development bank which grants medium and long term credit facilities. Eg IDBI, UTI

Bank lending principles

- ✓ Banks consider several factors in lending.
- ✓ An ideal lending is the one which is granted to a reliable customer for an approved purpose.
- ✓ For this the banker should follow the underlying principles

1. Principle of Safety

- ✓ "Safety first" is the cardinal principle of sound lending.
- ✓ When a bank lends, it must ensure that the advance is safe; i.e. the money will definitely be returned back.

- ✓ For example, if a borrower invests in an unproductive or speculative venture, or if the borrower himself is dishonest, the advance would be insecure.
- ✓ Credit worthiness of the borrower can be checked through various mechanisms such as credit ratings, CIBIL records.

2. Principle of Liquidity

- ✓ Paying the deposited money on demand of customers is called liquidity in banking terms
- ✓ This is possible when the money lent by banks comes back on demand or according to pre-agreed terms of repayment.
- ✓ The borrower must be in a position to repay within a reasonable time after a demand for repayment is made.
- ✓ This is more likely if the money is employed by the borrower for short-term requirements and not locked up in assets or schemes which take a long time to repay.
- ✓ The source of repayment must also be definite.

3. Principle of security

- ✓ It has been the practice of banks not to lend as far as possible except against security.
- ✓ Securities can be : Personal security or Collateral security
- ✓ This is considered as a cushion to fall back upon in case of an emergency.
- ✓ For instance: the security offered must be
    - ✓ adequate,
    - ✓ readily marketable, and
    - ✓ easy to handle
- ✓ Security of lending automatically ensures liquidity of lending too

4. Principle of Profitability

- ✓ Equally important is the principle of ‘profitability’.
- ✓ Banks have to pay interest on the deposits received by them.

- ✓ They have to incur expenses on maintaining their establishments.
- ✓ They have to make provision for depreciation and also for, possible bad or doubtful debts.
- ✓ Therefore a reasonable profit must be made by the bank to remain a going concern.
- ✓ Otherwise, it will not be possible to transfer any funds to the reserve or to pay dividend to the shareholders.
- ✓ It is after considering all these factors a bank decides its lending interest rate.

5. Principle of Diversity

- ✓ Another important principle of good lending is the diversification of advances.
- ✓ It is important to spread the risks involved in lending over
    - o a large number of borrowers,
    - o a large number of industries and areas
- ✓ The advantage in diversification is , in case of non-recovery of funds due to slump in one sector the funds can be collected from the vibrant sector of the economy
- ✓ "Do not put all the Eggs in one basket"

6. Principle of National Interest

- ✓ The advance should not be utilized against national interest or existing government regulations, etc.
- ✓ It should also not be against the banks' policy / motto.
- ✓ For example, NABARD (National bank for Agriculture and Rural Development) lends more towards rural projects (agriculture).
- ✓ It may not be suitable to change the area of its operation to power project.
- ✓ Such things need to be considered along with the other principles of lending.

Various Credit Products/Facilities

Credit Facility is an agreement with bank that enables a person or organization to take credit or borrow money when it is needed. All types of credit facilities may broadly be classified into two groups on the basis of Funding –

1. Fund Base Credit
2. Non Fund Base Credit

1. Fund Base Credit

(i) Loan: – It refers to credit facility that is repayable in a definite period. (e.g. Term Loan , Demand Loan)

(ii) Cash Credit: – It refers to credit facility in which borrower can borrow any time with in the agreed limit for certain period for their working capital need.

- ✓ It secured by way of Hypothecation of Stock(goods) and Debtors and all other current Assets of the business generated during the course of business.
- ✓ Cash credit can also be secured by way of mortgage of immovable properties (as collateral

(iii) Over Draft: – An overdraft allows a current account holder to withdraw in excess of their credit balance up to a sanctioned limit.

- ✓ It secured by way of Mortgage of immovable properties and pledge of F.D., Bonds, Shares securities , Gold & silver and any physical asset and Hypothecation of Stock and Debtors and all other current Assets of the business generated during the course of business.

(iv) Packing Credit: – It is a credit facility which sanctioned to an exporter in the Pre-Shipment stage.

- ✓ Such credit facilitates the exporter to purchase raw materials at competitive rates and manufacture or produce goods according to the requirement of the buyer and organize to have it packed for onward export.

- ✓ It secured by way of Hypothecation of Stock of goods and Debtors and all other current Assets of the business generated during the course of business.

(v) Some other fund based credit facilities are Bill Discounted , Bill Purchased , Advance against hypothecation of Vehicles (Transport Loan) , House Building Loan , Consumer Loan , Agriculture Loan -Farming -Non Farming , Consortium Loan , Lease Financing , Hire Purchase , Import Financing – Loan Against Imported Merchandise (LIM) – Payment Against Document (PAD) .

(2) Non-Fund Base credit is a credit facility where there is no involvement of direct outflow of Bank's fund on account of borrower rather the outflow of Bank's fund on account of Third party on behalf of borrower.

Types of it are as follow:

(i) Letter Of Credit: – When a buyer or importer wants to purchase goods from an unknown seller or exporter. He can take assistance of bank in such buying or importing transactions.

- ✓ Bank issues a LETTER OF CREDIT in addressed to the supplier or exporter after it, supplier or exporter will supply the goods to such unknown buyer or importer. A signed Invoice with Letter Of Credit is presented to the bank of buyer/importer and the payment is made to the seller/exporter DIRECTLY by the bank.

(ii) Bank Guarantee: – It is a guarantee issued by a banker that, in case of an occurrence or non-occurrence of a particular event, the bank guarantees to fulfil the loss of money as stipulated in the contact.

- ➢ It may of various types like Financial Guarantees, Performance Guarantees and Deferred Payment Guarantee.

(iii) Buyer Credit: – It is the credit availed by an Importer from overseas lenders (i.e. Banks & Financial Institutions) for payment against his imports. (for goods they are importing)

- ✓ The overseas bank usually lends the Importer based on letter of credit, bank guarantee issued by the importer bank.

(iv) Suppliers Credit: – Under such credit facility an exporter extends credit to a foreign importer to finance his purchase.

- ✓ Usually the importer pays a portion of the contact value in cash and issues a Promissory note as evidence of his obligation to pay the balance over a period of time.
- ✓ The exporter thus accepts a deferred payment from the importer and may be able to obtain cash payment by discounting or selling such promissory note created with his bank.

Securities for lending

The nature and the kind of security are broadly classified into two categories such as

1. Personal security and
2. Collateral security.

Personal security

- Personal security constitutes the acquaintance and guarantee of the borrower in securing the loan from a bank
- Loans advanced under this category are called clean loans
- For E.g. Loans are provided usually to respectable customers with whom the bank is well acquainted
- Good faith is the foundation on which the loans are granted, banker do not insist on any security at all

Collateral security

- Collateral security constitutes physical securities executed by the borrower in favor of the banker before advancing loans
- For example, tangible assets both movable and immovable
- Movable assets: Eg inventory of goods, warehouse receipts, shares etc
- Immovable assets: Eg Land, building, plant and machinery etc
- Borrowers can execute collateral security in any one of the ways:

- Hypothecation
- Pledge
- Mortgage

Types of collateral security

1. Stock exchange securities

- ✓ Securities such as equity shares and debentures and bonds issued by reputed industrial houses are accepted for providing loans
- ✓ Advancing loans against stock exchange security is advantageous as
  1. It can be easily sold at stock exchange
  2. There is an easy transfer of ownership
  3. Also there is no or minimum loss on sale of such securities

2. Goods and titles to goods

- ✓ Titles to goods against which loans are granted include
  - ➢ warehouse certificates,
  - ➢ railway receipts,
  - ➢ loading bills,
  - ➢ dock warrants, etc.
- ✓ Goods are hypothecated to the banker although goods physically remain under the custody of the borrower
- ✓ Further it is also possible for the borrower to make sale of those goods

3. Bills of exchange

- ✓ These are another important type of securities accepted by the banker
- ✓ Loans are provided either by the way of purchasing or discounting the genuine commercial bills ,in possession of the traders

- ✓ For instance, there is no possibility of any loss being suffered by the bank as the value of these exchange bill is not subject to change
- ✓ Bills serve as an ideal security for the banker since it is possible for the banker to rediscount the bill with central bank

4. Life of insurance policy

- ✓ Banks also advance loans against the security of life insurance policies
- ✓ Lending against these policy is attractive for the banker as the surrender value of the policy can be easily found out from the life insurance corporation
- ✓ The banker should not lend more than the surrender value of the policy
- ✓ For instance, endowment policies are recommended the most
- ✓ As the policy provides coverage to the insured for a specific period, at the end of which sum assured plus the accrued bonus is paid to the insurance holder.

5. Property

- Property include both movable as well as immovable assets
- Movable assets example, gold, silver, finished goods, stocks and shares, bills of exchange etc
- Immovable assets example, land, buildings, plant and machinery, etc
- Lending against movable properties is advantageous since it is possible for the banker to dispose off the assets easily.

WORKING CAPITAL AND TERM LOANS

- ✓ Working capital loans are short-term with a repayment period of a few months.
- ✓ Term loans, on the other hand, can be short, medium, or long term.
- ✓ Their duration is usually between one to ten years, but some term loans could extend up to 30 years.

CREDIT APPRAISAL TECHNIQUES

- ✓ Credit appraisal is a process of appraising the credit worthiness of an applicant for a loan.
- ✓ To gauge the credibility of the borrower, his sources of
- ✓ income,
- ✓ age,
- ✓ experience,
- ✓ number of dependents,
- ✓ repayment capacity,
- ✓ past and existing loans,
- ✓ nature of employment and
- ✓ other assets are taken into account.

CREDIT MANAGEMENT

- ✓ Credit management is the process of
- ✓ Granting credit,
- ✓ Setting the terms it's granted on,
- ✓ Recovering this credit when it's due,
- ✓ Ensuring compliance with company credit policy, among other credit related functions.
- ✓ Ensuring an adequate Allowance for Doubtful Accounts is kept by the company.

WHAT ARE THE OBJECTIVES OF CREDIT MANAGEMENT?

- ✓ Safeguarding Customer Risk.
- ✓ Settlement of Outstanding Balances.
- ✓ Improving Cash Flow.

Credit Facility

Credit Facility is an agreement with bank that enables a person or organization to be taken credit or borrow money when it is needed. All types of credit facilities may broadly be classified into two groups on the basis of Funding – 1. Fund Base Credit 2. Non Fund Base Credit

1. Fund Base Credit is the any credit facility which involves direct outflow of Bank's fund to the borrower. Various types of it are as follows :-

(i) Loan: – It refers to credit facility that is repayable in a definite period. (e.g. Term Loan , Demand Loan)

(ii) Cash Credit: – It refers to credit facility in which borrower can borrow any time with in the agreed limit for certain period for their working capital need. It secured by way of Hypothecation of Stock(goods) and Debtors and all other current Assets of the business generated during the course of business. Cash credit can also be secured by way of mortgage of immovable properties (as collateral security).

(iii) Over Draft: – An overdraft allows a current account holder to withdraw in excess of their credit balance up to a sanctioned limit. It secured by way of Mortgage of immovable properties and pledge of F.D., Bonds, Shares securities , Gold & silver and any physical asset and Hypothecation of Stock and Debtors and all other current Assets of the business generated during the course of business.

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(2) Non Fund Base credit is a credit facility where there is no involvement of direct outflow of Bank's fund on account of borrower rather the outflow of Bank's fund on account of Third party on behalf of borrower. Types of it are as follow:

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Suppliers Credit: – Under such credit facility an exporter extends credit to a foreign importer to finance his purchase. Usually the importer pays a portion of the contact value in cash and issues a Promissory note as evidence of his obligation to pay the balance over a period of time. The exporter thus accepts a deferred payment from the importer and may be able to obtain cash payment by discounting or selling such promissory note created with his bank.

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SCHOOL OF MANAGEMENT STUDIES

UNIT – IV -PRINCIPLES AND PRACTICES OF BANKING – SBAA1303

UNIT 4: BANKING REGULATIONS AND FINANCIAL STABILITY

NEED AND IMPORTANCE OF BANKING REGULATIONS IN INDIA - BANKING REGULATION ACT 1949 - KYC AND AML GUIDELINES - BANKING FRAUD - BANKING CODE - BASEL NORMS - SARFAESI ACT - ARCS - BANKING OMBUDSMAN SCHEME - POLICIES WITH RESPECT TO PRIORITY SECTORS AND MSMEs

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WHAT IS BANK REGULATION?

- **Bank regulation** is a form of government regulation which subjects' banks to certain requirements, restrictions and guidelines, designed to create market transparency between banking institutions and the individuals and corporations with whom they conduct business, among other things.

NEED AND IMPORTANCE OF BANKING REGULATIONS IN INDIA

- **Regulation** and strong supervision can help stop **banks** making similar mistakes in the future.
- **Banks** also won't think about how their actions could affect other **banks**, the whole financial system and even the wider society.
- **Regulation** helps to reduce many of the problems that could get a **bank** into financial difficulty.
- **Regulations** are indispensable to the proper functioning of economies and societies.
- They underpin markets, protect the rights and safety of citizens and ensure the delivery of public goods and services.
- At the same time, **regulations** are rarely costless.

Example of banking regulation?

- **Banks** have **regulations** at the federal, state, and sometimes local levels.
- **Examples of bank regulations** include capital requirements and limits on interest rates.

- Member **banks** of the Federal Reserve are subject to further **regulations**, such as the requirement to buy stock in the Federal Reserve System.

BANKING REGULATION ACT 1949

- The BR **Act** provides a framework for **supervision** and **regulation** of all **banks**.
- It also gives the RBI the power to grant licenses to **banks** and regulate their business operation.
- FEMA is the primary exchange control **legislation in India**.
- FEMA and the rules made there under regulate cross-border activities of **banks**

KYC policy

- The know your customer or know your client guidelines in financial services requires that professionals make an effort to verify the identity, suitability, and risks involved with maintaining a business relationship.
- It also enables banks to understand its customers and their financial dealings to serve them better and manage its risks prudently.

For the purpose of KYC policy, a 'Customer' is defined as : –

- A person or entity that maintains an account and/or has a business relationship with the bank; – one on whose behalf the account is maintained (i.e. the beneficial owner); –
- Beneficiaries of transactions conducted by professional intermediaries, such as Stock Brokers, Chartered Accountants, Solicitors etc. as permitted under the law,
- and – any person or entity connected with a financial transaction which can pose significant reputational or other risks to the bank, say, a wire transfer or issue of a high value demand draft as a single transaction.

AML GUIDELINES

- Anti-money laundering (AML) refers to the laws, regulations and procedures intended to prevent criminals from disguising illegally obtained funds as legitimate income.

- Though anti-money laundering laws cover a limited range of transactions and criminal behavior, their implications are far-reaching.
- For example, AML regulations require banks and other financial institutions that issue credit or accept customer deposits to follow rules that ensure they are not aiding.
- The purpose of the **AML rules** is to help detect and report suspicious activity including the predicate offenses to money laundering and terrorist financing, such as securities fraud and market manipulation.
- Firms must comply with the Bank Secrecy Act and its implementing regulations ("**AML rules**").

BANKING FRAUD

- **Bank fraud** is the use of potentially illegal means to obtain money, assets, or other property owned or held by a financial institution, or to obtain money from depositors by fraudulently posing as a **bank** or other financial institution.
- In many instances, **bank fraud** is a criminal offence.
- **TYPES OF BANKING FRAUD:**
  - **Accounting fraud**
  - In order to hide serious financial problems, some businesses have been known to use fraudulent bookkeeping to overstate sales and income, inflate the worth of the company's assets, or state a profit when the company is operating at a loss.

Demand draft fraud

- **Demand draft fraud refers to a type of fraud in which the dishonest bank employees,**
- **who know the coding and punching of a demand draft (DD), will remove a few demand draft leaves or DD books from the stock of a bank**
- **and then they will write on such DD so that it looks like a regular DD.**

- **Subsequently these demand drafts will be issued to a distant town/city without debiting an account for payment.**

- **Since for the paying branch it is just another DD, such DD will be cashed at the payable branch.**

BANKING CODE

- The **Banking Code** of Practice is a set of promises outlining how

  a **bank** should conduct itself in its dealings with customers, as well as specific requirements for **banking** services.

- A **bank code** is a **code** assigned by a central **bank**, a **bank** supervisory body or a Bankers Association in a country to all its licensed member banks or financial institutions.

- The rules vary to a great extent between the countries.
- Also the name of **bank codes** varies.

BASEL NORMS

- Why the name Basel?
- Basel is a city in Switzerland.
- It is the headquarters of the Bureau of International Settlement (BIS), which fosters cooperation among central banks with a common goal of financial stability and common standards of banking regulations.

- It was founded in 1930.
- The Basel Committee on Banking Supervision is housed in the BIS offices in Basel, Switzerland.

What are Basel norms?

- Basel norms or Basel accords are the international banking regulations issued by the Basel Committee on Banking Supervision.((BCBS)

- The Basel norms is an effort to coordinate banking regulations across the globe, with the goal of strengthening the international banking system.

- It is the set of the agreement by the Basel committee of Banking Supervision which focuses on the risks to banks and the financial system.

What is the Basel committee on Banking Supervision?

- The Basel Committee on Banking Supervision (BCBS) is the primary global standard setter for the prudential regulation of banks and provides a forum for regular cooperation on banking supervisory matters for the central banks of different countries.
- It was established by the Central Bank governors of the Group of Ten countries in 1974.
- The committee expanded its membership in 2009 and then again in 2014.
- The BCBS now has 45 members from 28 Jurisdictions, consisting of Central Banks and authorities with responsibility of banking regulation.
- It provides a forum for regular cooperation on banking supervisory matters.
- Its objective is to enhance understanding of key supervisory issues and improve the quality of banking supervision worldwide.

Why these norms?

- Banks lend to different types of borrowers and each carries its own risk.
- They lend the deposits of the public as well as money raised from the market i.e, equity and debt.
- This exposes the bank to a variety of risks of default and as a result they fall at times.
- Therefore, Banks have to keep aside a certain percentage of capital as security against the risk of non – recovery.
- The Basel committee has produced norms called Basel Norms for Banking to tackle this risk.

What are these norms?

- The Basel Committee has issued three sets of regulations which are known as Basel-I, II, and III.

Basel-I

- It was introduced in 1988.
- It focused almost entirely on credit risk.
- Credit risk is the possibility of a loss resulting from a borrower's failure to repay a loan or meet contractual obligations.
- Traditionally, it refers to the risk that a lender may not receive the owed principal and interest.
- It defined capital and structure of risk weights for banks.
- The minimum capital requirement was fixed at 8% of risk weighted assets (RWA).
- RWA means assets with different risk profiles.
- For example, an asset backed by collateral would carry lesser risks as compared to personal loans, which have no collateral.
- India adopted Basel-I guidelines in 1999.

Basel-II

- In 2004, Basel II guidelines were published by BCBS.(Basel Committee on Banking Supervision)
- These were the refined and reformed versions of Basel I accord.
- The guidelines were based on three parameters, which the committee calls it as pillars.
- Capital Adequacy Requirements: Banks should maintain a minimum capital adequacy requirement of 8% of risk assets
- Supervisory Review: According to this, banks were needed to develop and use better risk management techniques in monitoring and managing all the three types of risks

that a bank faces, viz. credit, market and operational risks.

- Market Discipline: This needs increased disclosure requirements.

- Banks need to mandatorily disclose their CAR, risk exposure, etc to the central bank.

- Basel II norms in India and overseas are yet to be fully implemented though India follows these norms.

Basel III

- In 2010, Basel III guidelines were released.
- These guidelines were introduced in response to the financial crisis of 2008.
- A need was felt to further strengthen the system as banks in the developed economies were under-capitalized, over-leveraged and had a greater reliance on short-term funding.

- It was also felt that the quantity and quality of capital under Basel II were deemed insufficient to contain any further risk.

- The guidelines aim to promote a more resilient banking system by focusing on four vital banking parameters viz. capital, leverage, funding and liquidity.

- Capital: The capital adequacy ratio is to be maintained at 12.9%.

- The minimum Tier 1 capital ratio and the minimum Tier 2 capital ratio have to be maintained at 10.5% and 2% of risk-weighted assets respectively.

- In addition, banks have to maintain a capital conservation buffer of 2.5%. Counter-cyclical buffer is also to be maintained at 0-2.5%.

Leverage: The leverage rate has to be at least 3 %.

- The leverage rate is the ratio of a bank’s tier-1 capital to average total consolidated assets.

- Funding and Liquidity: Basel-III created two liquidity ratios:
- LCR(liquidity coverage ratio) and
- NSFR (Net Stable Funds Rate)
- The liquidity coverage ratio (LCR) will require banks to hold a buffer of high-quality liquid assets sufficient to deal with the cash outflows encountered in an acute short term stress scenario as specified by supervisors.
- This is to prevent situations like “Bank Run”.
- The goal is to ensure that banks have enough liquidity for a 30-days stress scenario if it were to happen.
- The Net Stable Funds Rate (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).
- The minimum NSFR requirement is 100%.
- Therefore, LCR measures short-term (30 days) resilience, and NSFR measures medium-term (1 year) resilience.

Tier 1 Capital vs. Tier 2 Capital

- Banks have two main types of capital that are qualitatively different from one another.
- Tier 1: It refers to a bank's core capital, equity, and the disclosed reserves that appear on the bank's financial statements.
- In the event that a bank experiences significant losses, Tier 1 capital provides a cushion that allows it to weather stress and maintain a continuity of operations.

- Tier 2: It refers to a bank's supplementary capital, such as undisclosed reserves and unsecured subordinated debt instruments that must have an original maturity of at least five years.

- Tier 2 capital is considered less reliable than Tier 1 capital because it is more difficult to accurately calculate and more difficult to liquidate.

- Credit Risk - Credit risk is most simply defined as the potential that a bank's borrower or counterparty may fail to meet its obligations in accordance with agreed terms.

- Market Risk - Market risk refers to the risk to a bank resulting from movements in market prices in particular changes in interest rates, foreign exchange rates and equity and commodity prices.

What is Sarfaesi act?

- The Securitisation and Reconstruction of Financial Assets and Enforcement of Securities Interest Act, 2002 (also known as the SARFAESI Act) is an Indian law.

- It allows banks and other financial institution to auction residential or commercial properties (of Defaulter) that have been pledged with them to recover loans from borrowers .

What is the procedure of Sarfaesi act?

- There are two main methods provided in the SARFAESI Act for recovery of non-performing assets :

- Securitisation: Securitisation is the process of issuing marketable securities backed by a pool of existing assets such as auto or home loans.
- After an asset is converted into a marketable security, it is sold.
- A securitisation company or reconstruction company may raise funds from only the QIB (Qualified Institutional Buyers) by forming schemes for acquiring financial assets.

Asset Reconstruction:

- Enacting SARFAESI Act has given birth to the Asset Reconstruction Companies in India.

- It can be done by either proper management of the business of the borrower, or by taking over it or by selling a part or whole of the business or by the rescheduling of payment of debts payable by the borrower enforcement of security interest in accordance with the provisions of this Act.

Role of High Court

- The SARFAESI Act, 2002 allows High Court to entertain certain matters related to the implementation of the SARFAESI Act in the state of Jammu & Kashmir.

- However, High Courts have been entertaining write petitions under article 226 (Power to issue writs) of the constitution of India.

- Applicability of the Act
- The SARFAESI Act is not applicable to:
- Regional Rural Banks
- Nationalized Banks
- Co-operative Banks

State Bank of India and their Associate banks Who can issue notice under Sarfaesi Act?

- The Act empowers the Bank:
- To issue demand notice to the defaulting borrower and guarantor, calling upon them to discharge their dues in full within 60 days from the date of the notice.

- To give notice to any person who has acquired any of the secured assets from the borrower to surrender the same to the Bank.

What is ARC in banking?

- Accounts receivable conversion (ARC) is a process that allows paper cheque to be electronically scanned and converted into an electronic payment through the Automated Clearing House (ACH).

- This refers explicitly to cheque that companies receive in payment for an account receivable.

BANKING OMBUDSMAN

- An official mechanism set up by the RBI for the resolution and settlement of complaints relating to provision of banking and financial services, is called a ,Banking Ombudsman.

INTRODUCTION

- The Banking Ombudsman Scheme is introduced under Section 35 A of the Banking Regulation Act, 1949 by RBI with effect from 1995.
- The Banking Ombudsman is a senior official appointed by the Reserve Bank of India to redress customer complaints against deficiency in certain banking services.
- Which are the banks covered under the Banking Ombudsman Scheme?
- All Scheduled Commercial Banks, Regional Rural Banks and Scheduled Primary Co-operative Banks are covered under the Scheme.

OBJECTIVES

- To provide an inexpensive, transparent and credible mechanism ensuring fair treatment of the common person utilizing Banking service.
- Solving of grievances, users of banking services inexpensive & fair to improve customer services.
- Feedback/suggestions to Reserve Bank: about guidelines to banks to improve the level of customer service &
- To strengthen their internal grievance redressed systems

- Create awareness: about Banking Ombudsman Scheme.

- To facilitate: Quick and fair (non-discriminatory) redressed of grievances through use of IT systems, comprehensive and easily accessible database and enhanced capabilities of staff through training

Grounds of complaints in Banking Services

- Forced closure of deposit accounts without due notice or without sufficient reason.

- Refusal to accept or delay in accepting payment towards taxes, as required by Reserve Bank/Government.

- Refusal to open deposit accounts without any valid reason for refusal.

- Complaints from Non-Resident Indians having accounts in India in relation to their remittances from abroad, deposits and other bank related matters.

- Non-payment or delay in payment of inward remittances.

- Non-payment or inordinate delay in the payment or collection of cheques, drafts, bills etc.,

Card related problems:

- Charging Of amount for 'Free' Card,
- Authorization Of Loans Over Phone (oral),
- Wrong Billing,
- Excessive Charges,
- Wrong Debits To Account,
- Non-dispensation /Short Dispensation Of Cash From ATM . Etc
- Complaints can be submitted online/ email/in hard copy
- Complaints from individuals/ their representatives(except advocates)/GOI/RBI

- Form of Complaint Receipt of complaint Review by BO (Beneficiary owner)

- Complaints arising out of frauds and forgery and sub judice cases (Supreme Court's observation that it would not be appropriate for BOs to give a finding on forgery or to form an opinion on cases already referred to courts)

Benefits

- Prompt and impartial resolution of complaints
- No cost to the customer
- Assessment based on overall fairness, good business practices, accepted banking law and practice

- Focus on customer education and financial literacy
- Customer Awareness and Empowerment

Procedure for Rectification of Grievance:

- Making a complaint
- Written Representation
- Time frame
- Subject matter
- Calling for information
- Settlement of complaint by agreement
- Recommendation for settlement
- Rejection of the complaint

POWERS OF BANKING OMBUDSMAN :

- ➢ To receive complaints relating to banking services.
- ➢ To consider such complaints relating to the deficiencies in the banking and other services and facilitate their satisfaction

- ➢ To receive complaints relating to non payment, delaying payment or collecting of cheque

- To receive complaints relating to claims in respect of unauthorized or fraudulent withdrawals from deposit accounts

POLICIES WITH RESPECT TO PRIORITY SECTORS AND MSMEs

What is included in priority sector lending?

As per the RBI circular released in 2016, there are eight broad categories of the Priority Sector Lending.

They are:

(1) Agriculture

(2) Micro, Small and Medium Enterprises

(3) Export Credit

(4) Education

(5) Housing

(6) Social Infrastructure

(7) Renewable Energy

(8) Others.

- Priority Sector Lending refers to lending to those sectors of the economy which may not get timely and adequate credit in the absence of this special dispensation.

- Priority Sector Lending is an important role given by the (RBI) to the banks for providing a specified portion of the bank lending to few specific sectors like agriculture and allied activities, micro and small enterprises, poor people for housing, students for education and other low income groups and weaker sections.

- This is essentially meant for an all-round development of the economy as opposed to focusing only on the financial sector.

Services covered under MSME

- **MSME covers** only manufacturing and **service** industries.
- Trading companies are not **covered** by the scheme.
- **MSME** is to support startups with subsidies and benefits, trading companies are just like middlemen, a link between manufacturer and customer.

MSME policy India

- The Government through the Ministry of Micro, Small and Medium Enterprises (MSME) has been implementing a number of schemes with the objective of having a vibrant MSME sector through the promotion of growth and development of micro, small and medium enterprises including khadi, village and coir industries in cooperation with concerned Ministries/Departments, State Governments and other stakeholders by providing support to existing enterprises and encouraging creation of new enterprises.

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SCHOOL OF MANAGEMENT STUDIES

UNIT – V – PRINCIPLES AND PRACTICES OF BANKING – SBAA1303

UNIT 5: ELECTRONIC BANKING

E Banking – Meaning – Benefits - Home Banking - Mobile Banking - Internet Banking - Virtual Banking - E- Payments - Atm Card /Bio Metric Card - Smart Card

E-banking is the automated delivery of new and traditional banking products and services Directly to customers through electronic and interactive communication channels.

Example: Personal Computer (PC) banking, Internet banking, home banking, virtual banking, phone banking, online banking and remote electronic banking. Electronic banking, or e-banking, is the term which describes the transactions taking place among companies, organizations, and individuals and their banking institutions. It was first conceptualized in the mid-1970s and some banks offered their customers electronic banking in 1985. The Internet explosion in the late-1990s made people more comfortable with making transactions over the web and despite the dot-com crash, e-banking grew alongside the Internet.

Electronic banking is a term combined used for the processes by which a customer may perform banking transactions electronically without visiting a brick-and-mortar institution. E-banking comprises of the systems that enable banks' customers — individuals or businesses, to check accounts, do business transactions, or fetch information on financial products and services through a public or private network, including the internet.

Customers can avail e-banking services by using electronic devices, such as a Personal Computer (PC), Personal Digital Assistant (PDA), Automated Teller Machine (ATM) and Kiosk, etc

Benefits of e-Banking

The greatest advantage of e- banking lies in the fact that customers are not required to wait in long and tiring lines of the banks for financial transactions or statements. Opening of accounts is quite easy now, there is flexibility while closing of accounts and bank loans can also be availed without having to visit any bank.

Banking has been made faster and convenient as compared to conventional banking since e-banking has tremendously reduced the time required for processing banking transactions. E-banking is cost-effective and caters to need of thousands of customers simultaneously.

These factors have considerably raised the profit margins of the banks which enable them to offer acceptable interest rates on savings account and credit cards.

In addition to availing banking facilities for 24 hours a day, important information regarding banking policies, rates of interest offered and formalities required in various transactions can also be received.

While availing the facilities of internet banking, one needs to be very careful so as not to become a victim of computer hacking which may lead to unauthorized use of your account by computer hackers.

Though banks have come up with several security measures, the customers are also required to be a bit careful to ensure security and safety of Internet banking.

Disadvantages of e-banking

E-Banking presents potential disadvantages:

Security: Although banks generally offer secure web pages to carry out your business transactions, this doesn't guarantee complete safety. Even secure websites may be susceptible to internet criminals who try to hack into your account and gain access to your financial information. This may lead to deceitful use of your business's identity and potentially cost you thousands of dollars.

Site Disruption: A technical fault could cause the banks website to go offline for a certain period of time, which can result in problems for you and your business. Routine site maintenance also occurs, although this normally takes place during off-peak hours.

User Apprehension: Some people may not feel comfortable with the idea of placing critical financial information into an online account, or may be worried about using the Internet.

Accessibility: If the business is located in a rural or remote area, the internet options may be limited. Depending on the type of business, conducting transactions may seem difficult.

Internet banking

Online **banking** allows a user to conduct financial transactions via the **Internet**. Online **banking is** also known as **Internet banking** or web **banking**. Online **banking** offers customers almost every service traditionally available through a local branch including deposits, transfers, and online bill payments.

Home banking

Under home banking, the customer can get banking services sitting at home or office without visiting the branch. Number of routine transaction can be undertaken by the customer like, knowing the balance, getting a statement of account etc

Types Home Banking:

The home banking broadly classified into two categories

- Home banking using internet.
- Home banking without using internet

Home banking using internet: The various facilities that can be enjoyed by a customer by using internet in home Banking are:

- Account details
- Payment of bill.
- Electronic fund transfer.

Account details: View your bank account details, account balance download statement. Demat, loan and credit card account details all in one place. Electronic fund transfer Online trading.

Real Time Gross Settlement (RTGS)

RTGS stands for Real Time Gross Settlement. According to RBI, “RTGS can be defined as the continuous (real-time) settlement of funds transfers individually on an order by order basis (without netting)”.

This happens through the secure network INFINET provided by IDRBT, an initiative of Reserve Bank of India for research in Banking Technology.

Considering that the funds settlement takes place in the books of the Reserve Bank of India, the payments are final and irrevocable. The RTGS system is primarily meant for large transactions. The minimum amount to be remitted Salient Features

Customers can remit any amount using RTGS. Customers aiming remission of money through

RTGS have to provide the following particulars:

IFSC (Indian Financial System Code) of the beneficiary Bank/Branch.

Full account number of the beneficiary.

Name of the beneficiary.

Aadhar bridge payments

Distribution of Electronic Benefit transfer (crediting the bank accounts of the beneficiaries as identified from the UID number – eliminating thereby payment leakages) called Aadhaar Payments Bridge

Providing basic financial services (cash deposit, balance enquiry, cash withdrawal and remittance) at low cost access devices (called Micro ATMs) maintained at Business correspondents in an inter-operable way called Aadhaar Enabled Payment Service.

Aadhaar Payment Bridge Solution (APBS) will be used to - EBT Credit disbursements based on UID number.

To sub-serve the goal of Government of India (GOI) and Reserve Bank of India (RBI) in furthering Financial Inclusion by way of processing government disbursement using Aadhaar number.

To support various Schemes like NREGA, Social Security Pension, Handicapped Old Age Pension etc. of any Central or State Government bodies, to send financial details to the beneficiary using Aadhaar number.

Aadhaar Enabled Payment System Aadhaar Enabled Payment System (AEPS)

Is a bank led model which allows online financial inclusion transaction at Micro-ATM through the Business correspondent of any bank using the Aadhaar authentication

This system is designed to handle both ONUS and OFFUS requests seamlessly in an effective way by enabling authentication gateway for all Aadhaar linked account holders.

Aadhaar Payment Bridge Solution features

Pre supposes that all Government beneficiaries would have Aadhaar linked account number

Government Department can send file containing IIN, Aadhaar No., transaction reference no. and Amount. With the incorporation of Mapper, IIN no. need not be included in transaction file.

APBS will receive the disbursal payment instruction from the Government Departments through Sponsor Bank – (Banks has ability to convert in the required format)

The bank identifier would be used to route transaction to the destination bank

The destination bank will maintain the linkage to Aadhaar number and bank account for seamless credit to customer account

Enriched MIS to participants

Secure Clearing and Settlement

Services Offered ϖ Balance Enquiry ϖ Cash Withdrawal ϖ Cash Deposit ϖ Aadhaar to Aadhaar Fund Transfer Best Finger Detection(BFD) ϖ Mini Statement (Proposed)

Rupay Card

Is an Indian domestic card conceived and launched by NPCI in 2012. Therefore, we can say that RuPay Card is an Indian payment gateway. It also works like Visa or Master Card and its commission is low. RuPay facilitates electronic payment at all Indian banks and financial institutions

RuPay Card, a product of NPCI, is an Indian version of credit and debit cards and has been designed to address the needs of Indian consumers, merchants and banks.

As per NPCI, the benefits of RuPay card are the **flexibility** of the product platform, high levels of acceptance and the **strength** of the RuPay brand.

Key Features:

India's first domestic card scheme with Aadhaar

First of its kind unique product – ATM + PoS+ MicroATM Card

Use at any NFS ATM & MicroATM for Cash withdrawal, Cash Deposit, Balance Enquiry, Funds transfer to any other Aadhaar number

Use at PoS to avail RuPay scheme based purchase transactions

Acts as a usual ATM card when entered in any of the NFS ATMs using PIN issued by the bank

When swiped on MicroATM goes through the AEPS system where biometrics is used to authenticate the transaction with UIDAI authority.

Acts as a normal PoS based transaction while swiped on a PoS (PIN)

National Automated Clearing House, or **NACH**, introduced by National Payments Corporation of India, is a centralised clearing service that aims at providing interbank high volume, low value transactions that are repetitive and periodic in nature.

The centralised payment/transaction **processing** system by the National Payments Corporation of India (NPCI), National Automated Clearing House (**NACH**), lets you simplify and manage bulk payment across multiple banks and manage payments of utility bills, SIPs, premiums, donations, Credit Card bills or any other recurring

Step-by-step process of how NACCH works:

- The corporate (or money-collecting agency) collects the NACH mandate form from customers. With the mandate form, the customer gives the corporate the authority to debit his account for a certain period and at a certain frequency.
- The corporate verifies the details provided by the customer in the mandate form.
- After verification of details, the corporate forwards the NACH mandate to its bank.
- The corporate's bank then shares the NACH mandate with the NPCI.
- Once the information is validated, the NPCI forwards the mandate to the customer's bank for approval. Only fully validated transactions are forwarded to the customer's bank for debiting.
- Once approved by the customer's bank, the corporate is authorised to collect funds from the customer's account.

Virtual Banking

(VB) is a strategy of distribution channels which are used to provide financial services and seeks to expand the concept of the traditional bank branch. It allows **banks** to expand in new markets, reduce operational issues, take **banking** services to the doorsteps of its existing & potential customers.

Advantages

♣ Round the clock Banking.

♣ User friendly.

♣ Portability and speed of banking is the biggest asset.

♣ Efficiency.

♣ Quality.

♣ Ubiuity.

Disadvantages

- ♣ Initial setup cost.
- ♣ Training and maintenance.
- ♣ Legal Issues.
- ♣ **Security issues**

Security Risks. ♣ Increasing number of fraudulent websites. ♣ Fake emails which appear to have been from the bank. ♣ Mails which say we have won so many dollars as lottery. ♣ Use of Trojan horse to capture User ids and passwords.

Mobile banking

Fig 3

Is a facility which enables customers to initiate and/or perform banking tasks on their mobile phones. This is provided by most of the banks in India and abroad. Customers can use mobile banking to view their account balance, make instant fund transfers and pay bills, etc.

There are various types of mobile banking, viz. via SMS, USSD and mobile apps. Some of the banks like SBI, have incorporated services like loan approval and linking of insurance policy in their mobile banking apps.

Types of Mobile Banking Services

Mobile banking is one step closer to creating a completely digitalized environment. It lessens paperwork and shrinks waiting time which is otherwise wasted in long queues.

Banks provide mobile banking services to their clients in the different ways listed here:

- Mobile Banking over mobile applications (for smartphones; e.g. SBI Yono and iMobile by ICICI Bank, etc.)
- Mobile Banking over SMS (also known as SMS Banking)
- Mobile Banking over Unstructured Supplementary Service Data (USSD)

Mobile Banking – Services Available

Mobile banking is useful to customers in the following ways:

Access to Account Information

Information is power. And thus, knowing your exact bank balance is important. This helps you in better management of your funds. And thus, this is the primary mobile banking service provided by any bank. You can check the following:

- View account balance (balance enquiry)
- Transaction history
- e-statement of account
- Loan statements
- Card statements
- e-Passbooks

Transactions

Making payments and transferring money from one account to another is the most basic banking activity. Therefore it only makes sense that these are the most used and in-demand mobile banking services. You can transfer funds to anyone by adding them as beneficiaries or simply via Unified Payments Interface or UPI.

- Bank to bank transfers
- Transfer of funds to self

- Payments to third parties (rent payments, bill payment, etc.)
- Giving standing instructions for periodic payments
- Payments via NEFT/IMPS/RETG/UPI/MMID

3. **Investments**

- Opening fixed deposit/recurring deposits
- Mutual fund investments
- Portfolio management services (e.g. SBI Capital Securities)

Other Services

Apart from the account summary, bill payments, fund transfers and investments, there are other services that a customer requires for smooth banking experience. Also, there may be times when you have some grievances and due to lack of time, are not able to address. For such extra services, you can always resort to your bank's mobile banking and find solutions to your complaints or queries.

These services include:

- ATM locators
- Branch locators
- Lodging complaint/ tracking applications
- Ordering new cheque book
- Cancelling/stopping an issued cheque

Concept of e-money

Broadly, electronic money is an electronic store of monetary value on a technical device. The definition of electronic money is becoming more scientific and specific with developments associated with it.

The European Central Bank defines e-money in the following words. "E-money can be defined as amount of money value represented by a claim issued on a prepaid basis, stored in an electronic medium (card or computer) and accepted as a means of payment by undertakings other than the issuer” (ECB).

E money is a monetary value that is stored and transferred electronically through a variety of means – a mobile phone, tablet, contactless card (or smart cards), computer hard drive or servers.

Electronic money need not necessarily involve bank accounts in transaction but acts as a prepaid bearer instrument. They are often used to execute small value transactions.

What is Electronic Money?

Scrip or money that is exchanged only through electronically is referred to as electronic money. Electronic Money is also referred as e – money, Electronic Cash, Digital Money, Electronic Currency, Digital Currency, e – currency, Digital Cash, and Cyber Currency.

Electronic Money uses Internet, Digital Stored Value systems, and Computer Networks.

Some of the examples of electronic money are Direct Deposit, EFT (Electronic Funds Transfer), Virtual Currency, and Digital Gold Currency.

Different Systems of Electronic Money:

Electronic Money includes three different systems namely:

Centralized Systems,

Decentralized Systems, and

Offline Anonymous Systems.

Centralized Systems:

There are many centralized systems that directly sell their e – currency to end users is Web Money, Pay Pal, Hub Culture Ven, and Cash U but Liberty Reserve sells only via 3rd party digital currency exchangers.

Decentralized Systems:

Electronic Money includes some decentralized systems. They are:

Bitcoin, and Ripple Monetary System.

(i) Bitcoin:- Bitcoin is a Peer to Peer Electronic Money system with maximized inflation limit.

(ii) Ripple Monetary System:- Ripple Monetary system is a system that is developed to distribute electronic money system independent to local currency.

Offline Anonymous System:

Offline Anonymous System can be done 'offline'. In this electronic money system, the merchants do not need to have interaction with banks before receiving currency from the users. Instead of that, the merchants can collect spent money by users and deposits the money later to the bank. The merchant can deliver his storage media in bank for exchanging the electronic money to cash.

E-Purse

Indian Bank is also a Wallet with the following features: • Physical Debit Card issued - Can use in ATM / POS (not in other Wallets) • Master Card Wallet - Wide Merchant acceptability across the globe. • Card Protector - Primary account is not exposed to public website.

An **electronic purse** is the store of value on a **card**, which can be used in a manner similar to cash to pay for travel or for other small-scale transactions. The **electronic** "**purse**" is secure information stored in a dedicated area or file in the smart-**card**.

E-Purse Advantages • Convenient mode of carrying money because it is expected to substitute coins and currency notes and hence used for paying online utility bills. • Preservation of resources in terms of manpower, money, time, less printing and minting of notes and coins respectively. • It is important to note that the issuer and the service provider (acceptor) has the identical value for the cards in single-purpose EPurse card.

Types of E-Purse

A.Single-Purpose E-Purse Card The single-purpose card is designed to function for only one type of transaction, e.g., public transport, telephone services, ducational institutions, hospitals, telephone calls, laundry or any specific utility service.

The card generally comes with a magnetic chip which stores the information about the amount loaded or funded. European Central Bank (ECB) has exempted these Singlepurpose pre-paid cards from the purview of their policy initiatives on e-money.

It is important to note that the issuer and the service provider (acceptor) has the identical value for the cards in singlepurpose E-purse card.

B. Closed or Limited Purpose e-Purse Card The scope of the closed E-Purse is limited in nature as it is not treated like money and hence cannot be used everywhere. A select number of vendors or service providers only accept the e-Purse.

The closed e-Purses have one issuer or type of value and are generally used in a small number of already selected or identified points of sale (PoS) locations. The mass transit systems of New York, San Francisco, and Washington all use prepaid cards.

C. Open or Multi-Purpose E-Purse Card The scope of the open e-Purse is wider. The value stored in the open. E-Purse may be equated to currency as it can be used for a wider range of transactions.

It may perform variety of functions in association with multiple vendors, like, debit card, smart card etc.

Salient Features of E-Purse

- E-Purse stores pre-paid monetary value in the form of electronic money and are used to purchase or pay for goods or services in particular smart card schemes.
- Value can be loaded into e-Purse either by paying cash or by earning points, depending on the scheme.
- E-Purses can be loaded by bank transfers.
- E-Purse can also be loaded by Banks. ATMs, Cash / Coin Dispensers, etc., by which the value of the inserted cash is transferred into the inserted smart card.

The risks in e-banking are as follows

Operational risk

Security risk

System architecture & design risk

Reputational risk

Legal risks

Money laundering risk

Strategic risk

Other risk

ATM or biometric cards

A card used in an Automated Teller Machine (ATM) to access a credit or a debit account to complete banking inquiries and fund transfers between accounts.

How Does an ATM card Work?

When a debit card is used, the transaction debits the amount of the transaction from the checking account, generally on the same day. A debit card can be used to get cash from ATM machines or have it swiped like a credit card at shops or restaurants or swipe it through a pay phone to make a call.

Details on an ATM card

Front of card contains following: Notes

1. Name: Name of person authorized to use ATM card.

2. Card No: This is a unique 16-digit number embossed on card.

3. Validity: Card is valid for use from the day one receives it till the last day of the

month/ year (MM/YY) indicated in the card.

4. Visa Logo/Master Card Logo.

Reverse of card contains:

1. Signature Panel: Panel with card holder signature.

2. Contact information / Help line Numbers.

3. Magnetic stripe: The most important and secured part of the card. It is made up of tiny Iron-based magnetic particles in a plastic-like film. It stores card holder's name, and the Card number, the expiry date, along with other bank-specific information.

Factors Determining Credit Card Interest in India

Depending on their credit worthiness, the credit card interest rate in India varies from bank to bank and even person to person. Still the banks setup credit card interest in India by taking into Consideration the following factors:

1. Prime Lending Rate (PLR): This is the standard rate, based on which banks determine the interest rates of various loan products

Example: A bank may decide to setup a credit card interest at a fixed rate of 0.5% over the PLR. This means that if the PLR increases or decreases, the card interest will vary accordingly.

2. Repo rate: This is the rate at which the Reserve Bank of India lends money to other commercial banks in the nation. Consequently, if this rate increases, the banks charge higher interest rates on its credit cards.

3. Reverse repo rate: This is the rate at which the RBI borrows from commercial banks. Therefore, if this rate is high, the banks have more funds and are willing to lower credit card Rates.

Parties Involved in a Credit Card Transaction

The various parties involved in a credit card transaction are:

1. Cardholder: The card bearer who makes the purchase, i.e. the consumer.

2. Card-issuing bank: The financial institution which issues the credit card to the cardholder. This bank bills the consumer for repayment and bears the risk that the card is used deviously. Cards issued by banks to cardholders in a different country are known as "offshore credit cards".

3. Merchant: The individual or business which accepts the credit card payments for products or services sold to the card bearer

4. Acquiring bank: The financial institution which accepts the payment for the products or Notes services on behalf of the merchant.

5. Independent sales organization: Resellers (to merchants) of the services of the acquiring bank.

6. Merchant account: This refers to the organization that the merchant deals with.

7. Credit Card association: An association of card-issuing banks such as Visa, MasterCard, American Express, etc. that set transaction terms for merchants, card-issuing banks, and acquiring banks.

8. Transaction network: The system that enforces the mechanism of the electronic transactions. It may be operated by an independent company, and one company may operate multiple networks.

9. Affinity partner: Some institutions lend their names to an issuer to attract customers that have a strong relationship with that institution, and get paid a fee or a percentage of the balance for each card issued using their name. For example, sports teams, universities, charities, professional organizations, and major retailers.

Credit Card Transaction Process

Authorization:

For making the payment the credit card holder makes purchases and swipes the card. The merchant submits the transaction to the acquirer (acquiring bank) and the acquirer verifies the credit card number of the holder and the transaction type. Authorization process generates an approval code which the merchant keeps secured as official record of the transaction.

2. **Batching:** Batching refers to keeping of the entire day's transactions together or in 'batches' before they are sent to the acquirer. These 'batches' are scheduled for submission at the end of business day. Clearance of those transactions which do not become part of the batch stays valid only for a period of time which is determined by the issuer. After the expiry of this time period the amount is returned to the credit card from where it was debited. Transactions that are submitted in the batch without prior authorizations can be those transactions that fall under the merchant's floor limit.

3. **Clearing and Settlement:**

The clearing and settlement process begins with the merchant requesting to the acquirer for final transfer of transaction batch. This request is imparted through the credit card association which leads to the transfer of money from the customer's account to the merchant's account. The transaction charges are basically imposed to the account of the issuer.

4. Funding: Once the money reaches the acquirer, the amount is transferred from the acquirer account to the merchant's account. The merchant receives the amount from the acquirer after deduction of the transaction fee, popularly known as ‘discount rate’. This is the fees that the merchant pays to the acquirer for processing the transaction.

5. Charge backs: In case of a dispute arising out of a transaction, chargeback comes into play. A chargeback is an event in which a purchase payment in a merchant account is held back due to a dispute relating to the transaction. Charge backs are mainly initiated by the cardholder. The issuer, in the event of a chargeback, returns the transaction to the acquirer for resolving the dispute. The acquirer, in turn, sends the chargeback to the merchant. The merchant then has the freedom of either accepting the chargeback or advocate it.

Different types of credit cards available by banks are:

1. Standard Credit Card: The account holder has to top up the amount once the level of the balance goes down. An outstanding balance gets a penalty charge.
2. Premium Credit Card: It is also called the Reward Credit Card. Some examples are airlines frequent flier credit card, cash back credit card, etc.
3. Secured Credit Card: People without credit history or with tarnished credit can avail this card.
4. Limited purpose Credit Card: There is limitation to its use and is to be used only for particular applications.
5. Charge Credit Card: This requires the card holder to make full payment of the balance every month and therefore there is no limit to credit.
6. Specialty Credit Card: For business purposes enabling businessmen to keep their businesses transactions separately in a convenient way.
7. Prepaid Credit Card: Money is loaded by the card holder on to the card. It is like a debit card except that it is not tied up with a bank account.

National Electronic Funds Transfer

NEFT has gained popularity as it saves time and the transactions can be concluded easily. National Electronic Funds Transfer (NEFT) is a nation-wide payment system facilitating one-to-one funds transfer. Under this Scheme, individuals, firms and corporates can electronically transfer funds from any bank branch to any individual, firm or corporate having an account with any other bank branch in the country participating in the Scheme.

Individuals, firms or corporate maintaining accounts with a bank branch can transfer funds using NEFT. Even such individuals who do not have a bank account (walk-in customers) can also deposit cash at the NEFT-enabled branches with instructions to transfer funds using

NEFT. However, such cash remittances will be restricted to a maximum of Rs.50,000/- per transaction. Such customers have to furnish full details including complete address, telephone number, etc. NEFT, thus, facilitates originators or remitters to initiate funds transfer transactions even without having a bank account. Individuals, firms or Corporates maintaining accounts with a bank branch can receive funds through the NEFT system. It is, therefore, necessary for the beneficiary to have an account with the NEFT enabled destination bank branch in the country. Presently, NEFT operates in hourly batches - there are twelve settlements from 8 am to 7 pm on week days (Monday through Friday) and six settlements from 8 am to 1 pm on Saturdays

Step-1 : An individual / firm / corporate intending to originate transfer of funds through NEFT has to fill an application form providing details of the beneficiary (like name of the beneficiary, name of the bank branch where the beneficiary has an account, IFSC of the beneficiary bank branch, account type and account number) and the amount to be remitted.

The application form will be available at the originating bank branch. The remitter authorizes his/her bank branch to debit his account and remit the specified amount to the beneficiary. Customers enjoying net banking facility offered by their bankers can also initiate the funds transfer request online. Some banks offer the NEFT facility even through the ATMs. Walk-in customers will, however, have to give their contact details (complete address and telephone number, etc.) to the branch. This will help the branch to refund the money to the customer in case credit could not be afforded to the beneficiary's bank account or the transaction is rejected / returned for any reason.

Step-2: The originating bank branch prepares a message and sends the message to its pooling centre (also called the NEFT Service Centre).

Step-3 The pooling centre forwards the message to the NEFT Clearing Centre (operated by National Clearing Cell, Reserve Bank of India, Mumbai) to be included for the next available batch.

Step-4: The Clearing Centre sorts the funds transfer transactions destination bank-wise and prepares accounting entries to receive funds from the originating banks (debit) and give the funds to the destination banks (credit). Thereafter, bank-wise remittance messages are forwarded to the destination banks through their pooling centre (NEFT Service Centre).

Step-5: The destination banks receive the inward remittance messages from the Clearing Centre and pass on the credit to the beneficiary customers' accounts.