**DEPARTMENT OF MANAGEMENT STUDIES**
**BA4003-BANKING & FINANCIAL SERVICES**
**UNIT-I**

**2MARKS:**

1. **Explain the concept of Banking?**

Banking is the business of protecting money for others. Banks lend this money, generating interest that creates profits for the bank and its customers. A bank is a financial institution licensed to accept deposits and make loans. But they may also perform other financial services.

2. **What is meant by commercial banks?**

A commercial bank is a financial institution that provides services like loans, certificates of deposits, savings bank accounts bank overdrafts, etc. to its customers. These institutions make money by lending loans to individuals and earning interest on loans.

3. **Definition of KYC norms.**

KYC full form is 'Know Your Customer') which refers to the process of identity and addresses verification of all customers and clients by banks, insurance companies and other institutions either before or while they are conducting transactions with their customers

4. **Define co-operative banks.**

A cooperative is an association of persons (organization) that is owned and controlled by the people to meet their common economic, social, and/or cultural needs and aspirations through a jointly-owned and democratically controlled business (enterprise).

5. **What is meant by financial distress?**

Financial distress is a condition in which a company or individual cannot generate sufficient revenues or income, making it unable to meet or pay its financial obligations. This is generally due to high fixed costs, a large degree of illiquid assets, or revenues sensitive to economic downturns.

6. **What is NPA's?**

NPA full form is Non-performing Assets. NPA is nothing but the loans that are being given by the Indian banks and other operating financial institutions whose interests as well as the principal amounts have been in a state of overdue status for a fairly long time.

7. **What is a negotiable instrument?**

A negotiable instrument is a signed document that promises a sum of payment to a specified person or the assignee. In other words, it is a formalized type of IOU: A transferable, signed document that promises to pay the bearer a sum of money at a future date or on-demand.

8. **What is mean by authorized, subscribed, paid up capital?**

Authorized share capital is the number of stock units (shares) that a company can issue as stated in its memorandum of association or its articles of incorporation.

**Subscribed share capital** refers to any capital raised through subscribed shares. Put simply, it's the value of all the shares that investors agree to purchase during a new issuance.

**Paid-up capital** is the amount of money a company has received from shareholders in exchange for shares of stock. Paid-up capital is created when a company sells its shares on the primary market directly to investors, usually through an initial public offering (IPO).

9. **Write a note on lien &set off.**

Lien is the right of a creditor to retain the goods &securities owned by his debtors until the debt is repaid

Set off:

Same name and same right, both the accounts must held in the same name & in the same capacity. this is to avoid misuse of funds belonging to someone else but standing in the name of the customer

**10. Write any four functions of bank?**

Accepting the Deposits.
Advancing the Loans.
Credit Creation.
A Cheque for paying the funds.
Paying and Collecting the Credit.
Purchasing and Selling of the Securities.
Bullion Trading.
Money Remittance.

**11. What is CAMEL?**

CAMELS is an international rating system used by regulatory banking authorities to rate financial institutions, according to the six factors represented by its acronym. The CAMELS acronym stands for "Capital adequacy, Asset quality, Management, Earnings, Liquidity, and Sensitivity."

**12. What is sensitivity analysis?**

Sensitivity analysis is a financial model that determines how target variables are affected based on changes in other variables known as input variables. It is a way to predict the outcome of a decision given a certain range of variables.

**13. What do you mean by capital adequacy?**

The capital adequacy ratios ensure the efficiency and stability of a nation's financial system by lowering the risk of banks becoming insolvent. Generally, a bank with a high capital adequacy ratio is considered safe and likely to meet its financial obligations.

**14. Define indigenous bank.**

Indigenous banking system is the system of banking that involves private firms or individuals who act as banks by providing financial services such as loans and accepting deposits. Indigenous banking system is made up of indigenous bankers who do not fall under the purview of the government.

**15. What is demonetization?**

Demonetization is the process of eliminating the lawful acceptance status of a monetary unit. It arises whenever the official currency is changed. The existing kind or types of currency are withdrawn through circulation and supplanted with new currency.

**16. What is 'Financial Services'?**

Financial services ensure promotion of domestic as well as foreign trade. The presence of factoring and forfaiting companies ensures increasing sale of goods in the domestic market and export of goods in the foreign market. Banking and insurance services further contribute to step up such promotional activities.

**17. Write about call money.**

Call money is short term finance repayable on demand, with a maturity period of one to fifteen days, used for inter-bank transactions. The money that is lent for one day in this market is known as "call money" and, if it exceeds one day, is referred to as "notice money".

**18. Write a note promissory note.**

A promissory note is a legal, financial tool declared by a party, promising another party to pay the debt on a particular day. It is a written agreement signed by drawer with a promise to pay the money on a specific date or whenever demanded.

**19. Write about cheque.**

A "cheque is a bill of exchange drawn on a specified banker and not expressed to be payable otherwise than on demand and it includes the electronic image of a truncated cheque and a cheque in the electronic form.

**20. What is repo rate& reverse repo rate?**

Repo rate is the rate at which banks borrow money from the central banks with out any sale of securities.

Reverse repo rate

The rate of interest at which the central bank borrows funds from other banks for the short term durations.

**21. What do you meant by Hundis?**

Hundi is an unconditional order in writing made by a person directing another to pay a certain sum of money to a person named in the order. Hundis, being a part of the informal system have no legal status and are not covered under the Negotiable Instruments Act, 1881.

**22. What is scheduled bank?**

Scheduled banks are those banks that are listed under Schedule II of the Reserve Bank of India Act, 1934. The bank's paid-up capital and raised funds must be at least Rs. 5 lakh to qualify as a scheduled bank. These banks are liable for low interest loans from the RBI.

**23. Define bill discounting.**

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

**24. What is bill of exchange?**

A "bill of exchange" is an instrument in writing containing an unconditional order, signed by the maker, directing a certain person to pay on demand or at fixed or determinable future time a certain sum of money only to, or to the order of, a certain person or to the bearer of the instrument.

**25. Define overdraft.**

An overdraft occurs when there isn't enough money in an account to cover a transaction or withdrawal, but the bank allows the transaction anyway. Essentially, it's an extension of credit from the financial institution that is granted when an account reaches zero.

## UNIT-II

**2MARKS:**

1. **What is credit syndication?**

Loan syndication occurs when two or more lenders come together to fund one loan for a single borrower. Syndicates are created when a loan is too large for one bank or falls outside the risk tolerance of a bank. The banks in a loan syndicate share the risk and are only exposed to their portion of the loan.

2. **Define new issue market.**

This new issue can be an Initial Public Offering (IPO) of a company or it can be a new issue floated by an organization that has floated many such issues in the past. The market that deals with these new issues is called the new issue market, as opposed to the secondary market that deals with existing shares and bonds.

3. **Define financial sickness.**

The Reserve Bank of India has defined a sick unit as one "which has incurred a cash loss for one year and is likely to continue incurring losses for the current year as well as in the following year and the unit has an imbalance in its financial structure, such as, current ratio is less than 1: 1 and there is worsening

4. **Define ALM.**

Asset/liability management is the process of managing the use of assets and cash flows to reduce the firm's risk of loss from not paying a liability on time. Well-managed assets and liabilities increase business profits. Asset and liability management is conducted from a long-term perspective that manages risks arising from the accounting of assets vs. liabilities. As such, it can be both strategic and tactical. A monthly mortgage is a common example of a liability that a consumer pays for from current cash inflows.

5. **What is risk management?**

Risk management is the process of identifying, assessing and controlling financial, legal, strategic and security risks to an organization's capital and earnings. These threats, or risks, could stem from a wide variety of sources, including financial uncertainty, legal liabilities, strategic management errors, accidents and natural disasters.

6. **What is conglomerate merger?**

A conglomerate merger is a merger between firms that are involved in totally unrelated business activities. These mergers typically occur between firms within different industries or firms located in different geographical locations. There are two types of conglomerate mergers: pure and mixed.

7. **Define solvency risk.**

Solvency risk is the risk that the business cannot meet its financial obligations as they come due for full value even after disposal of its assets. A business that is completely insolvent is unable to pay its debts and will be forced into bankruptcy.

8. **Define Z-SCORE MODEL.**

Altman's Z-score model is considered an effective method of predicting the state of financial distress of any organization by using multiple balance sheet values and corporate income. Altman's idea of developing a formula for predicting bankruptcy started at the time of the Great Depression, when businesses experienced a sharp rise in incidences of default.

9. **Define Hazard model.**

**Hazard model, proportional-hazard model** A statistical technique for determining 'hazard functions', or the probability that an individual will experience an event (for example first employment) within a particular time-period, given that the individual was subject to the risk that the event might occur (in this case, given continuing initial unemployment).

10. **What is meant by lending?**

Lending (also known as "financing") occurs when someone allows another person to borrow something. Money, property, or another asset is given by the lender to the borrower, with the expectation that the borrower will either return the asset or repay the lender.

11. **Write the different types of lending?**

i) Fund based lending:
   - Loans
   - Cash credit
   - Overdraft
   - Bills purchased and discounted

ii) Non-fund based lending:
   - Bank guarantees
   - Letter of credit

iii) Asset based lending:
   - Project finance
   - securitisation

12. **What is open-ended loan?**

An open-ended loan is a loan that does not have a definite end date. Examples of open-ended loans include lines of credit and credit cards. The terms of open-ended loans may be based on an individual's credit score.

13. **How to lenders set interest rate on loan?**

Banks set interest rates correspondingly to the rates set by the Federal Reserve. They also consider the interest rates charged by competitors. On a specific loan, banks take into consideration the borrower's creditworthiness, which includes their credit score, income, savings, and other financial metrics.

14. **Write short notes on bankruptcy?**

Bankruptcy is a legal process where you're declared unable to pay your debts. It can release you from most debts, provide relief and allow you to make a fresh start. You can enter into voluntary bankruptcy.

**15. Define risk charting.**

The chart allows you to rate potential risks on these two dimensions. The probability that a risk will occur is represented on one axis of the chart – and the impact of the risk, if it occurs, on the other. You use these two measures to plot the risk on the chart.

**16. Explain restrictive crossing.**

Restrictive Crossing – It directs the collecting banker that he needs to credit the amount of cheque only to the account of the payee. Where some customary instruction is written between the two parallel transverse lines (constituting crossing of cheque) that may result in imposing certain restrictions on the collecting or paying banker, it is called restrictive crossing.

**17. What are demand deposits?**

A demand deposit is money deposited into a bank account with funds that can be withdrawn on-demand at any time. The depositor will typically use demand deposit funds to pay for everyday expenses. For funds in the account, the bank or financial institution may pay either a low or zero interest rate on the deposit.

**18. Define endorsement.**

Endorsement means signing at the back of the instrument for the purpose of negotiation. The act of the signing a cheque, for the purpose of transferring to the someone else, is called the endorsement of Cheque. The endorsement is usually made on the back of the cheque. If no space is left on the Cheque, the Endorsement may be made on a separate slip to be attached to the Cheque.

**19. What is meant by pricing of deposits?**

The deposit rate is the interest rate paid by commercial banks or financial institutions on cash deposits of account holders. Deposit accounts include certificates of deposit (CD), savings accounts, and other investment accounts.

**20. Define merger.**

A merger is an agreement that unites two existing companies into one new company. There are several types of mergers and also several reasons why companies complete mergers. Mergers and acquisitions (M&A) are commonly done to expand a company's reach, expand into new segments, or gain market share.

A bank merger occurs when at least two financial institutions join together under a single charter. Usually, one institution will take over in name during a bank merger. But in rare instances, banks may create a newly chartered bank with a different name.

**21. Give an example of horizontal merger in banking sector in the recent times.**

Horizontal mergers: It refers to two firms operating in same industry or producing ideal products combining together. For e.g., in the banking industry in India, acquisition of **Times Bank by HDFC Bank, Bank of Madura by ICICI Bank, Nedungadi Bank by Punjab National Bank etc.**

**22. What is commercial lending?**

A commercial loan is **a financial instrument that businesses owners can avail of to address any short-term capital needs**. The sanctioned amount can be used to increase the working capital, acquire new machinery, build new infrastructure, meet operational costs, and other such expenditures.

**23. What do you meant by Credit monitoring?**

A credit monitoring service tracks changes in borrower behavior to notify consumers of potential fraud, as well as changes to their creditworthiness. Credit monitoring is important when it comes to staying on the top of your financial health. With this service, the possibility of credit fraud and identity theft is curtailed.

**24. What is meant by transactional risk?**

Transaction risk refers to the adverse effect that foreign exchange rate fluctuations can have on a completed transaction prior to settlement. It is the exchange rate, or currency risk associated specifically with the time delay between entering into a trade or contract and then settling it.

**25. What are certificate of deposit?**

A certificate of deposit (CD) is defined as an investment instrument mostly issued by banks, requiring investors to lock in funds for a fixed term to earn premium rates. It is like a savings account. For example, Joe invested $5,000 in CD with a bank at a fixed interest rate of 5% with 5 years maturity.

## UNIT-III

**2MARKS:**

1. **What is interest spread?**

Interest rate spread is the interest rate charged by banks on loans to private sector customers minus the interest rate paid by commercial or similar banks for demand, time, or savings deposits. The terms and conditions attached to these rates differ by country, however, limiting their comparability.

2. **What is capital adequacy ratio?**

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

3. **List out the fund based services of commercial bank.**

Commercial banks provide basic banking services and products to the general public, both individual consumers and small to mid-sized businesses. These services include checking and savings accounts, loans and mortgages, basic investment services such as CDs, as well as other services such as safe deposit boxes.

4. **What is meant by EFT?**

Electronic Fund Transfer (EFT) is an RBI-backed Electronic Payment System. EFT enables the transfer of money via electronic mediums, reducing the dependence on cash or cheque transfers. Your fund transfer request goes through several entities before reaching the beneficiary.

5. **What is mean by cost plus margin pricing?**

Cost-plus pricing is also known as markup pricing. It's a pricing method where a fixed percentage is added on top of the cost it takes to produce one unit of a product (unit cost). The resulting number is the selling price of the product. For example, you may decide you want to sell pies for 10% more than the ingredients cost to make them. Your price would then be 110% of your cost.

6. **Define E-Money.**

Electronic money (e-money) is broadly defined as an electronic store of monetary value on a technical device that may be widely used for making payments to entities other than the e-money issuer. The device acts as a prepaid bearer instrument which does not necessarily involve bank accounts in transactions.

7. **What is meant by e-banking?**

E-banking is a blanket term used to indicate a process through which a customer is allowed to carry out, personal or commercial banking transactions using electronic and telecommunication network. E-banking covers facilities such as – fund transfer, checking account statements, utility bill payments, opening of bank account, locating nearest ATM, obtain information on financial products and services, applying for loans, etc.

8. **What are ATMs?**

An ATM, which stands for automated teller machine, is a specialized computer that makes it convenient to manage a bank account holder's funds. It allows a person to check account balances, withdraw or deposit money, print a statement of account activities or transactions, and even purchase stamps.

9. **What is meant by RTGS?**

The acronym 'RTGS' stands for Real Time Gross Settlement, which can be explained as a system where there is continuous and real-time settlement of fund-transfers, individually on a transaction-by-transaction basis (without netting).

10. **Define NEFT.**

NEFT means **National Electronic Funds Transfer**. It is a mode of money transfer that enables one-to-one payments within India. NEFT is owned and operated by the Reserve Bank of India, and through this facility, you can transfer money from one account to another. It is a secured, economical, reliable and efficient system of funds transfer between banks

**11. What is unsecured loan?**

An unsecured loan is a loan that doesn't require any type of collateral. Instead of relying on a borrower's assets as security, lenders approve unsecured loans based on a borrower's creditworthiness. Examples of unsecured loans include personal loans, student loans, and credit cards.

**12. What is customer profitability analysis?**

A customer profitability analysis (CPA) looks at the revenue (or profit) that each individual customer generates. While activity-based costing examines individual cost drivers to determine the profitability of a product, a customer profitability analysis applies this same approach to customers

**13. What are credit and debit cards?**

A **credit card** is a type of credit facility, provided by banks that allow customers to borrow funds within a pre-approved credit limit. It enables customers to make purchase transactions on goods and services.
A **Debit Card** is a plastic currency or plastic money. You can use it to buy things when you don't have cash. Typically, the banks issue a Debit Card to Savings Account holders, and it is linked to your account. All transactions made through your Debit Card are reflected in your bank account statement.

**14. What is project financing?**

Project financing is a loan structure that relies primarily on the project's cash flow for repayment, with the project's assets, rights, and interests held as secondary collateral. Project finance is especially attractive to the private sector because companies can fund major projects off-balance sheet (OBS).

**15. Define ECS.**

Electronic Clearing System (ECS) is an electronic method of fund transfer from one bank account to another. It is generally used for bulk transfers performed by institutions for making payments like dividend, interest, salary, pension, etc.

**16. What are the objectives of internet banking?**

- To enable bank customers to use mobile instruments as a channel for accessing their banks accounts and remit funds.
- Making payment simpler just with the mobile number of the beneficiary.
- To sub-serve the goal of Reserve Bank of India (RBI) in electronification of retail payments.

**17. What is plastic money?**

Plastic money is a real term in finance. Is it referred to the wire transfers of funds from bank. Let us get a more holistic idea of what is plastic money. Plastic money refers to these cards. Debit and credit cards represent plastic money. Plastic money has made it easier for us to carry out transactions in our daily lives.

**18. What do you mean by letter of credit?**

A letter of credit is essentially a financial contract between a bank, a bank's customer and a beneficiary. Generally issued by an importer's bank, the letter of credit guarantees the beneficiary will be paid once the conditions of the letter of credit have been met.

**19. What is dinner club card?**

Diners Club was the first independent credit card issuer, offering people the first multipurpose charge card, and a number of years later, the first rewards program. Today, it has a focus on travel and offers exclusive benefits for club members.

**20. What is Amex card?**

American Express cards are either credit cards or charge cards issued by the publicly-traded financial services company—American Express. These cards are also referred to as AmEx cards and are quite unique in the way they operate. You can make purchases with your American Express® Card in a variety of ways.

No matter how you choose to pay, you'll enjoy the same world-class service, security features, benefits and rewards.

**21. List the types of ATMs.**

Onsite ATM
Offsite ATM
Worksite ATM
Cash Dispenser
Mobile ATM

**22. Distinguish between RTGS and NEFT.**

| NEFT (National Electronic Funds Transfer) | RTGS (Real-Time Gross Settlement) |
|---|---|
| Through National Electronics Funds Transfer, transactions of any amount can be sent to the recipient's account without any maximum limit to the funds that can be sent in a day | Large amounts of funds can be used to transfer instantly with Real-Time Gross Settlement. The transaction speed is faster than any other form of online payment. |
| The National Electronic Funds Transfer method does not have a minimum transfer limit ceiling. | The minimum amount needed to be transferred has to be of Rs. 2 Lakhs and above for RTGS |
| The settlement of funds happens on a half-hourly basis | The settlement of funds is instantaneous and happens in real-time |
| The NEFT mode is used when the transactions are of smaller values. | RTGS is used in high-value transaction |

**23. What is smart card?**

A smart card is a device that includes an embedded integrated circuit that can be either a secure microcontroller or equivalent intelligence with internal memory or a memory chip alone. The card connects to a reader with direct physical contact or with a remote contactless radio frequency interface.

**24. Define paper based payment.**

Paper-based payment modes offered under the CMS payment solutions include cheque printing, Demand draft printing and Internet-based cheque writing.paper-based. adjective. ACCOUNTING. used to describe a system that keeps information on paper, rather than on a computer.

**25. Write about induced sickness.**

Sickness behavior refers to a coordinated set of behavioral changes that develop in sick individuals during the course of an infection. At the molecular level, these changes are due to the brain effects of proinflammatory cytokines such as interleukin-1 (IL-1) and tumor necrosis factor alpha (TNFalpha).

## UNIT-IV

**2MARKS:**

1. **Define NBFC.**

A non-banking financial institution (NBFI) or non-bank financial company (NBFC) is a financial institution that does not have a full banking license or is not supervised by a national or international banking regulatory agency and is involved in the lending business, hire-purchase, leasing, insurance business, receiving deposits in some cases, chit funds, stocks, and shares acquisition, etc.

2. **What are financial services?**

Financial services is a broad range of more specific activities such as banking, investing, and insurance. Financial services are limited to the activity of financial services firms and their professionals, while financial products are the actual goods, accounts, or investments they provide.

3. **What is leasing?**

A lease is a contract outlining the terms under which one party agrees to rent an asset—in this case, property—owned by another party. It guarantees the lessee, also known as the tenant, use of the property and guarantees the lessor (the property owner or landlord) regular payments for a specified period in exchange. Both the lessee and the lessor face consequences if they fail to uphold the terms of the contract. A lease is a form of incorporeal right.

4. **Is there any difference between financial lease and operating lease?**

| BASIS FOR COMPARISON | FINANCE LEASE | OPERATING LEASE |
|---|---|---|
| Meaning | A commercial arrangement in which the lessor allows the lessee to use the asset for the maximum part of its economic life against payment of rentals is known as finance lease. | A commercial arrangement in which the lessor allows the lessee to use the asset for a term smaller than the economic life of the asset against the payment of rentals is known as operating lease. |
| Nature | Loan Agreement | Rental Agreement |
| Lease Term | The lease term of finance lease is longer as compared to operating lease. | The lease term of operating lease is short. |
| Risk Bearing for obsolescence | Rests with the lessee | Rests with the lessor |

5. **What is meant by hire purchase?**

Hire purchase is an arrangement for buying expensive consumer goods, where the buyer makes an initial down payment and pays the balance plus interest in installments. The term hire purchase is commonly used in the United Kingdom and it's more commonly known as an installment plan in the United States.

6. **Define underwriting.**

Underwriting is the process an investor or institution evaluates, researches and quantifies a financial risk. The role of an underwriter is to evaluate financial risks, rates and rules for a loan or investment. Underwriters work in commercial banking, insurance, investment banking and medical stop-loss industries.

7. **What is mutual fund?**

A mutual fund is a pool of money managed by a professional Fund Manager. It is a trust that collects money from a number of investors who share a common investment objective and invests the same in equities, bonds, money market instruments and/or other securities.

8. **What are exchanges traded funds?**

An exchange-traded fund (ETF) is a basket of securities that trades on an exchange just like a stock does. ETF share prices fluctuate all day as the ETF is bought and sold; this is different from mutual funds, which

only trade once a day after the market closes. ETFs can offer lower operating costs than traditional open-end funds, flexible trading, greater transparency, and better tax efficiency in taxable accounts.

**9. What is volatility?**

Volatility often refers to the amount of uncertainty or risk related to the size of changes in a security's value. A higher volatility means that a security's value can potentially be spread out over a larger range of values.

**10. What is diversification?**

Diversification is a strategy that mixes a wide variety of investments within a portfolio in an attempt to reduce portfolio risk. Diversification is most often done by investing in different asset classes such as stocks, bonds, real estate, or crypto currency.

**11. Who is called hire purchaser?**

1. A hire purchaser is a person who possesses the goods under hire purchase agreement for use within an option to either purchase it or return after use. 2. Hire vendor: a hire vendor is a person who sells the goods under hire purchase agreement.

**12. Who is called lessee?**

The lessee is always the one using the asset temporarily. They never own the asset over the course of the lease. If ownership does transfer to the lessee, that transfer ends the lease. In our car example, a lessee would be the individual or entity to whom the car is on loan from the dealer or property owner.

**13. What is ratio analysis?**

Ratio analysis is a quantitative analysis of data enclosed in an enterprise's financial statements. It is used to assess multiple perspectives of an enterprise's working and financial performance such as its liquidity, turnover, solvency and profitability.

**14. What is primary market?**

The primary market is **where securities are created**, while the secondary market is where those securities are traded by investors. In the primary market, companies sell new stocks and bonds to the public for the first time, such as with an initial public offering (IPO).

**15. Write notes on new issue market?**

A new issue is a stock or bond which is being offered for the first occasion to investors. This new issue may be a corporation's Initial Public Offering (IPO) or a new issue floated by an entity that has previously floated several similar issues. Where this issue will come is known as the new issue market.

**16. What is meant by green shoe option?**

A greenshoe option is an over-allotment option. In the context of an initial public offering (IPO), it is a provision in an underwriting agreement that grants the underwriter the right to sell investors more shares than initially planned by the issuer if the demand for a security issue proves higher than expected.

**17. What is put option and call option?**

A call option gives the holder the right to buy a stock and a put option gives the holder the right to sell a stock. Think of a call option as a down payment on a future purchase. Options involve risks and are not suitable for everyone. Options trading can be speculative in nature and carry a substantial risk of loss.

**18. Write note on security market?**

A securities market is a system of interconnection between all participants (professional and nonprofessional) that provides effective conditions: to attract new capital by means of issuing new security (securitization of debt) to transfer real asset into financial asset. Security is a financial instrument that can be traded between parties in the open market. The four types of security are debt, equity, derivative, and hybrid securities. Holders of equity securities (e.g., shares) can benefit from capital gains by selling stocks.

**19. Define merchant banking.**

Merchant banking refers to the financial and banking services provided by a merchant bank to large corporations and individuals with a high net worth. The services offered by merchant banks include underwriting, issue management, fundraising, loan syndication, portfolio management, financial advice, and more.

20. **Define factoring**.

Factoring is a financial transaction and a type of debtor finance in which a business sells its accounts receivable (i.e., invoices) to a third party (called a factor) at a discount. A business will sometimes factor its receivable assets to meet its present and immediate cash needs.

**21. What do you meant by forfeiting?**

Forfeiting is the way of financing of receivable related to international trade. It represents to the purchase done by bank and financial institutions of trade bills/promissory notes instead of recourse to the seller.

**22. Define venture capital.**

Venture capital (VC) is a form of private equity and a type of financing that investors provide to startup companies and small businesses that are believed to have long-term growth potential. Venture capital generally comes from well-off investors, investment banks, and any other financial institutions.

**23. List the types of leasing.**

- Financial Lease
- Operating Lease
- Sale and Lease Back Leasing
- Sales Aid Lease
- Specialized Service Lease
- Small Ticket and Big Ticket Leases
- Cross Border Lease

**24. What is firm underwriting?**

Firm underwriting - where an underwriter agrees to buy a certain number of shares/debentures in addition to the shares he has to take under the underwriting agreement. Even if the issue is oversubscribed, underwriters are responsible to take up the agreed number of shares in case of firm underwriting.

**25. What is sectoral fund?**

A sectoral fund is an equity fund that invests the money of investors in businesses belonging to the same industry or sector. These funds let investors take exposure in specific sectors of the economy by putting all their money in companies of the same sector.

## UNIT-V

**2MARKS:**

1. **What is insurance?**

   Insurance is **a way to manage your risk**. When you buy insurance, you purchase protection against unexpected financial losses. The insurance company pays you or someone you choose if something bad happens to you. If you have no insurance and an accident happens, you may be responsible for all related costs.

2. **What is portfolio manager?**

   A portfolio manager is a person or group of people responsible for investing a mutual, exchange traded or closed-end fund's assets, implementing its investment strategy, and managing day-to-day portfolio trading. A portfolio manager is one of the most important factors to consider when looking at fund investing.

3. **Define full factoring.**

   Full factoring merely **involves the administration of one's debts**. This means the bank or factoring house will initially contact the debtor to inform them that the debt has been factored, and to set up the necessary accounting and payment processes.

4. **What do you meant by invoice factoring?**

   Invoice factoring is a form of debtor financing service and helps avail external funding based on a business's receivables. Also known as debt factoring, it allows businesses to sell their client's unsettled bills to a third-party, called factor for funds.

5. **What is IRDA?**

The Insurance Regulatory Development Authority of India (IRDAI) is a regulatory body created with the aim of protecting the policyholder's interest. It also regulates and sees to the development of the insurance industry. The Authority acts as the regulator of the insurance industry in India and oversees the functioning of the Life Insurance and General Insurance companies operating in the country.

**6. What do you mean by seed capital?**

Seed capital is the initial amount of money an entrepreneur uses to start a business. Often, this money comes from family, friends, early shareholders or angel investors. Seed capital is typically used to support the planning of a business up to the point when the company starts selling a product or service.

**7. What are supply bills?**

A Bill of Supply is a document issued by GST Registered Businesses in place of a Tax Invoice. It is used by Composition Vendors and businesses dealing with Exempted Goods.

**8. What is credit delivery?**

In this system, the borrowers are allowed to draw funds from the account to the extent of the value of inventories and receivables less stipulated margin within the maximum permissible credit limit granted by the bank.

**9. Define bill discounting.**

Under this type of lending, Bank takes the bill drawn by borrower on his (borrower's) customer and pay him immediately deducting some amount as discount/commission. The Bank then presents the Bill to the borrower's customer on the due date of the Bill and collects the total amount.

**10. List the types of insurance.**

**i) Life insurance**

- Term policy
- Whole life policy
- Endowment policy
- Money-back policy
- Annuity
- Unit linked insurance policy

**ii) General insurance**

- Fire insurance
- Marine insurance
- Motor insurance
- Credit insurance
- Public liability insurance
- Fidelity insurance
- Burglary insurance

**11. Write the objectives of venture capital?**

- High Degrees of Risk
- Equity Participation
- Long Term Investment
- Participation in Management

**12. Write the role of merchant banks?**

- **Raising finance**

Merchant Bankers(MB) assist their clients in fund raising by way of issue of a debenture, shares, bank loans, etc.

- **Promotional activities**

In India, Activities of Merchant Banker play a very vital role of promoter of industrial enterprises. They assist entrepreneurs in the matter of conceiving ideas, identifying projects, preparation of feasibility reports, getting Government approvals as well as incentives, etc.

- **Brokers in stock exchanges**

Merchant bankers also buy and sell shares in the stock exchange on behalf of their clients. They also additionally conduct researches on equity shares.

- **Project management**

Merchant bankers offer their service to clients in several ways in the process of project management also.

**13. What do you meant by loan syndication?**

Loan syndication occurs when two or more lenders come together to fund one loan for a single borrower. Syndicates are created when a loan is too large for one bank or falls outside the risk tolerance of a bank. The banks in a loan syndicate share the risk and are only exposed to their portion of the loan.

**14. Who is called underwriter?**

An underwriter is any party, usually a member of a financial organization, that evaluates and assumes another party's risk in mortgages, insurance, loans, or investments for a fee in the form of a commission, premium, spread, or interest.

**15. What is IPO?**

IPO or an initial public offering is a process by which a privately held company sells its shares to investors and gets listed on the exchange.When a private company first sells shares of stock to the public, this process is known as an initial public offering (IPO). In essence, an IPO means that a company's ownership is transitioning from private ownership to public ownership. For that reason, the IPO process is sometimes referred to as "going public."

**16. Who is called lessor?**

A lessor is the owner of an asset that is leased, or rented, to another party, known as the lessee. Lessors and lessees enter into a binding contract, known as the lease agreement, that spells out the terms of their arrangement.

**17. Describe the role of SEBI.**

- **Securities issuers:** These entities get listed on the stock exchanges and raise funds by issuing shares. The SEBI makes sure that the initial public offering and post-public offer take place transparently.
- **Investors:** Investors are the most important part of the stock market and they are the ones who actively participate in the stock market. SEBI protects these investors by ensuring there is no fraud or stock market manipulation.
- **Financial sector intermediaries:** These intermediaries between the issuers and investors in the stock market make the financial transactions safe and smooth. SEBI takes charge of the activity of the stock market intermediaries.

**18. What is meant by public issue market?**

Primary market is a market wherein corporate issue new securities for raising funds generally for long term capital requirement. The companies that issue their shares are called issuers and **the process of issuing shares to public** is known as public issue.

**19. Define book value.**

The book value of a company is the difference in value between that company's total assets and total liabilities on its balance sheet. Value investors use the price-to-book (P/B) ratio to compare a firm's market capitalization to its book value to identify potentially overvalued and undervalued stocks.

**20. Define merger.**

A merger takes place when two companies combine to form a new company. Companies merge to reduce competition, increase market share, introduce new products or services, improve operations, and, ultimately, drive more revenue.

**21. What is FOREX risk?**

Foreign exchange risk refers to the losses that an international financial transaction may incur due to currency fluctuations. Foreign exchange risk can also affect investors, who trade in international markets, and businesses engaged in the import/export of products or services to multiple countries.

**22. What is translational risk?**

Translation exposure (also known as translation risk) is the risk that a company's equities, assets, liabilities, or income will change in value as a result of exchange rate changes. This occurs when a firm denominates a portion of its equities, assets, liabilities, or income in a foreign currency. It is also known as "accounting exposure."

**23. What do you meant by leading and lagging?**

Leading and lagging are two different forms of indicators that help in the assessment of the current state of any business and the prediction of its future conditions. The lagging indicators assess the current state of the business, whereas the leading indicators predict the future state of affairs.

**24. Define mitigation of risk.**

Risk mitigation is the process of planning for disasters and having a way to lessen negative impacts. Although the principle of risk mitigation is to prepare a business for all potential risks, a proper risk mitigation plan will weigh the impact of each risk and prioritize planning around that impact.

**25. What is rehabilitation?**

Rehabilitation would involve process to ensure that the Sick MSME Units become Viable. A unit would be considered as Sick, if. a. Any of the borrowal account of the enterprise remains NPA for three months or more.

## UNIT-I
## LONG ANSWERS

**13 MARKS:**

1. **Write an overview of Indian banking  system with its fuctions.**

The banking system of India consists of the central bank (Reserve Bank of India - RBI), commercial banks, cooperative banks and development banks (development finance institutions). These institutions, which provide a meeting ground for the savers and the investors, form the core of India's financial sector.

- Financial Sector in India consists of three main segments:
- Financial institutions -banks, mutual funds, insurance companies
- Financial markets -money market, debt market, capital market, forex market
- Financial products -loans, deposits, bonds, equities

***Structure of the Indian Banking System***

**Reserve bank of India:**

i) Scheduled banks

a) Co-operative banks

- State co-operative banks
- Central  co-operative banks
- Primary  agricultural credit banks

b) Commercial  banks

- Public sector banks
- Private sector banks
- Regional rural banks
- Foreign banks

ii) Non- scheduled banks

Reserve Bank of India is the central bank of the country and regulates the banking system of India. The structure of the banking system of India can be broadly divided into scheduled banks, non-scheduled banks and development banks.

Banks that are included in the second schedule of the Reserve Bank of India Act, 1934 are considered to be scheduled banks.

**All scheduled banks enjoy the following facilities:**

- Such a bank becomes eligible for debts/loans on bank rate from the RBI
- Such a bank automatically acquires the membership of a clearing house.

All banks which are not included in the second section of the Reserve Bank of India Act, 1934 are Non-scheduled Banks. They are not eligible to borrow from the RBI for normal banking purposes except for emergencies.

Scheduled banks are further divided into commercial and cooperative banks.

**Scheduled, Non-Scheduled Banks and Development Banks**

**Commercial Banks**

The institutions that accept deposits from the general public and advance loans with the purpose of earning profits are known as Commercial Banks.

Commercial banks can be broadly divided into public sector, private sector, foreign banks and RRBs.

- In Public Sector Banks the majority stake is held by the government. After the recent amalgamation of smaller banks with larger banks, there are 12 public sector banks in India as of now. An example of Public Sector Bank is State Bank of India.
- Private Sector Banks are banks where the major stakes in the equity are owned by private stakeholders or business houses. A few major private sector banks in India are HDFC Bank, Kotak Mahindra Bank, ICICI Bank etc.
- A Foreign Bank is a bank that has its headquarters outside the country but runs its offices as a private entity at any other location outside the country. Such banks are under an obligation to operate under the regulations provided by the central bank of the country as well as the rule prescribed by the parent organization located outside India. An example of Foreign Bank in India is Citi Bank.
- Regional Rural Banks were established under the Regional Rural Banks Ordinance, 1975 with the aim of ensuring sufficient institutional credit for agriculture and other rural sectors. The area of operation of RRBs is limited to the area notified by the Government. RRBs are owned jointly by the Government of India, the State Government and Sponsor Banks. An example of RRB in India is Arunachal Pradesh Rural Bank.

**Cooperative Banks**

A Cooperative Bank is a financial entity that belongs to its members, who are also the owners as well as the customers of their bank. They provide their members with numerous banking and financial services. Cooperative banks are the primary supporters of agricultural activities, some small-scale industries and self-employed workers. An example of a Cooperative Bank in India is Mehsana Urban Co-operative Bank.

At the ground level, individuals come together to form a Credit Co-operative Society. The individuals in the society include an association of borrowers and non-borrowers residing in a particular locality and taking interest in the business affairs of one another. As membership is practically open to all inhabitants of a locality, people of different status are brought together into the common organization. All the societies in an area come together to form a Central Co-operative Banks.

Cooperative banks are further divided into two categories - urban and rural.

- Rural cooperative Banks are either short-term or long-term.
    - Short-term cooperative banks can be subdivided into State Co-operative Banks, District Central Co-operative Banks, Primary Agricultural Credit Societies.

    - Long-term banks are either State Cooperative Agriculture and Rural Development Banks (SCARDBs) or Primary Cooperative Agriculture and Rural Development Banks (PCARDBs).
- Urban Co-operative Banks (UCBs) refer to primary cooperative banks located in urban and semi-urban areas.

**Development Banks**

- Financial institutions that provide long-term credit in order to support capital-intensive investments spread over a long period and yielding low rates of return with considerable social benefits are known as Development Banks.
- The major development banks in India are; Industrial Finance Corporation of India (IFCI Ltd), 1948, Industrial Development Bank of India' (IDBI) 1964, Export-Import Banks of India (EXIM) 1982, Small Industries Development Bank Of India (SIDBI) 1989, National Bank for Agriculture and Rural Development (NABARD) 1982.
- The banking system of a country has the capability to heavily influence the development of a country's economy. It is also instrumental in the development of rural and suburban regions of a country as it provides capital for small businesses and helps them to grow their business.
- The organized financial system comprises Commercial Banks, Regional Rural Banks (RRBs), Urban Co-operative Banks (UCBs), Primary Agricultural Credit Societies (PACS) etc. caters to the financial service requirement of the people.
- The initiatives taken by the Reserve Bank and the Government of India in order to promote financial inclusion have considerably improved the access to the formal financial institutions.
- Thus, the banking system of a country is very significant not only for economic growth but also for promoting economic equality.

2. **Explain the CAMELS rating system in India.**

The CAMELS Rating System was developed in the United States as a supervisory rating system to assess a bank's overall condition. A CAMEL is an acronym that represents the six factors that are considered for the rating. Unlike other regulatory ratios or ratings, the CAMELS rating is not released to the public. It is only used by top management to understand and regulate possible risks.

**C** - Capital Adequacy (20%)
**A** - Asset Quality (20%)
**M** - Management (25%)
**E** - Earnings (15%)
**L** - Liquidity (10%)
**S** - Sensitivity (10%)

**The components of CAMELS are:**

- (C)apital adequacy
- (A)ssets
- (M)anagement capability
- (E)arnings
- (L)iquidity
- (S)ensitivity

**Capital Adequacy**

Capital adequacy assesses an institution's compliance with regulations on the minimum capital reserve amount. Regulators establish the rating by assessing the financial institution's capital position currently and over several years.

Future capital position is predicted based on the institution's plans for the future, such as whether they are planning to give out dividends or acquire another company. The CAMELS examiner would also look at trend analysis, the composition of capital, and liquidity of the capital.

**Assets**

This category assesses the quality of a bank's assets. Asset quality is important, as the value of assets can decrease rapidly if they are high risk. For example, loans are a type of asset that can become impaired if money is lent to a high-risk individual.

The examiner looks at the bank's investment policies and loan practices, along with credit risks such as interest rate risk and liquidity risk. The quality and trends of major assets are considered. If a financial institution has a trend of major assets losing value due to credit risk, then they would receive a lower rating.

**Management Capability**

Management capability measures the ability of an institution's management team to identify and then react to financial stress. The category depends on the quality of a bank's business strategy, financial performance, and internal controls. In the business strategy and financial performance area, the CAMELS examiner looks at the institution's plans for the next few years. It includes the capital accumulation rate, growth rate, and identification of the major risks.

For internal controls, the exam tests the institution's ability to track and identify potential risks. Areas within internal controls include information systems, audit programs, and recordkeeping. Information systems ensure the integrity of computer systems to protect customer's personal information. Audit programs check if the company's policies are being followed. Lastly, record keeping should follow sound accounting principles and include documentation for ease of audits.

**Earnings**

Earnings help to evaluate an institution's long term viability. A bank needs an appropriate return to be able to grow its operations and maintain its competitiveness. The examiner specifically looks at the stability of earnings, return on assets (ROA), net interest margin (NIM), and future earning prospects under harsh economic conditions. While assessing earnings, the core earnings are the most important. The core earnings are the long term and stable earnings of an institution that is affected by the expense of one-time items.

**Liquidity**

For banks, liquidity is especially important, as the lack of liquid capital can lead to a bank run. This category of CAMELS examines the interest rate risk and liquidity risk. Interest rates affect the earnings from a bank's capital markets business segment. If the exposure to interest rate risk is large, then the institution's investment and loan portfolio value will be volatile. Liquidity risk is defined as the risk of not being able to meet present or future cash flow needs without affecting day-to-day operations.

**Sensitivity**

Sensitivity is the last category and measures an institution's sensitivity to market risks. For example, assessment can be made on energy sector lending, medical lending, and agricultural lending. Sensitivity reflects the degree to which earnings are affected by interest rates, exchange rates, and commodity prices, all of which can be expressed by Beta.

**How does the CAMELS Rating System Work?**

For each category, a score is given from one to five. One is the best score and indicates strong performance and risk management practices within the institution. On the other hand, five is the poorest rating. It indicates a high probability of bank failure and the need for immediate action to ratify the situation. If an institution's current financial condition falls between 1 and 5, it is called a composite rating.

- A scale of 1 implies that a bank exhibits a robust performance, is sound, and complies with risk management practices.
- A scale of 2 means that an institution is financially sound with moderate weaknesses present.
- A scale of 3 suggests that the institution shows a supervisory concern in several dimensions.

- A scale of 4 indicates that an institution has unsound practices, thus is unsafe due to serious financial problems.
- A rating of 5 shows that an institution is fundamentally unsound with inadequate risk management practices.

A higher number rating will impede a bank's ability to expand through investment, mergers, or adding more branches. Also, the institution with a poor rating will be required to pay more in insurance premiums.

**3. Discuss the overall functions performed by the commercial banks in India.**

A commercial bank is a kind of financial institution that carries all the operations related to deposit and withdrawal of money for the general public, providing loans for investment, and other such activities. These banks are profit-making institutions and do business only to make a profit.

The two primary characteristics of a commercial bank are lending and borrowing. The bank receives the deposits and gives money to various projects to earn interest (profit). The rate of interest that a bank offers to the depositors is known as the borrowing rate, while the rate at which a bank lends money is known as the lending rate.

**Function of Commercial Bank:**

The functions of commercial banks are classified into two main divisions.

**(a) Primary functions**

**Accepts deposit :** The bank takes deposits in the form of saving, current, and fixed deposits. The surplus balances collected from the firm and individuals are lent to the temporary requirements of the commercial transactions.

**Provides loan and advances :** Another critical function of this bank is to offer loans and advances to the entrepreneurs and business people, and collect interest. For every bank, it is the primary source of making profits. In this process, a bank retains a small number of deposits as a reserve and offers (lends) the remaining amount to the borrowers in demand loans, overdraft, cash credit, short-run loans, and more such banks.

**Credit cash:** When a customer is provided with credit or loan, they are not provided with liquid cash. First, a bank account is opened for the customer and then the money is transferred to the account. This process allows the bank to create money.

**(b) Secondary functions**

**Discounting bills of exchange:** It is a written agreement acknowledging the amount of money to be paid against the goods purchased at a given point of time in the future. The amount can also be cleared before the quoted time through a discounting method of a commercial bank.

**Overdraft facility:** It is an advance given to a customer by keeping the current account to overdraw up to the given limit.

**Purchasing and selling of the securities:** The bank offers you with the facility of selling and buying the securities.

**Locker facilities:** A bank provides locker facilities to the customers to keep their valuables or documents safely. The banks charge a minimum of an annual fee for this service.

**Paying and gathering the credit :** It uses different instruments like a promissory note, cheques, and bill of exchange.

**Types of Commercial Banks:**

There are three different types of commercial banks.

**Private bank –:** It is a type of commercial banks where private individuals and businesses own a majority of the share capital. All private banks are recorded as companies with limited liability. Such as Housing Development Finance Corporation (HDFC) Bank, Industrial Credit and Investment Corporation of India (ICICI) Bank, Yes Bank, and more such banks.

**Public bank –:** It is a type of bank that is nationalised, and the government holds a significant stake. For example, Bank of Baroda, State Bank of India (SBI), Dena Bank, Corporation Bank, and Punjab National Bank.

**Foreign bank –:** These banks are established in foreign countries and have branches in other countries. For instance, American Express Bank, Hong Kong and Shanghai Banking Corporation (HSBC), Standard & Chartered Bank, Citibank, and more such banks.

**Examples of Commercial Banks**

Few examples of commercial banks in India are as follows:

1. State Bank of India (SBI)
2. Housing Development Finance Corporation (HDFC) Bank
3. Industrial Credit and Investment Corporation of India (ICICI) Bank
4. Dena Bank
5. Corporation Bank

**4. Explain the rights and obligations of bankers.**

**Banker Rights and Obligations**

A banker is a person who is doing banking activities or business. A banker is an officer of a bank. In a broad sense, banker conducts the business of banking. A banker is a person who is doing banking activities or business. **To continue providing the best banking services to the customers, the banker has some rights and obligations that must be implemented and followed.** Let's take a look at all the rights and obligations of bankers.

**The rights of bankers are;**

- Rights of general lien.
- Rights of the set-off.
- Rights of appropriation.
- Rights to Charge Interest and Commission
- Rights to Close the Account

The rights of a banker that the banker can enjoy are as follows:

- **Rights of General Lien**

One of the most important rights enjoyed by a bank is the right of a general lien.

Lien means the right of the creditor to retain the goods or securities owned by the debtor until the debt due from him is repaid. In other words, the lien is a right of a person to retain goods belonging to another; until the demands of the person in possession are satisfied.

There are some exceptional cases in which the right of general lien is not applicable. These are:

- Safe custody deposit.
- Documents deposited for a special purpose.
- Security held in trust.

- **The Right of the 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 to 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 customer's credit against the debit balance in the other account. The bank has a right to combine the two accounts.

A banker possesses the right of set-off, which enables him to combine two accounts in the same customer's name and adjust the debit balance in one account with the credit balance in the other. The right of set-off can be exercised subject to the fulfillment of the following conditions:

- The accounts must be in the same name on the same right.
- The right can be exercised regarding debts due only, not regarding future debts or contingent debts.

- The number of debts must be certain.
- The banker may exercise that right at his discretion.

➢ **Banker's Right of Appropriation**

A customer may owe several distinct debts to the bank when the customer deposits some money without specific instructions and is insufficient to discharge all debts. The problem arises as to 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.

If the customer has more than one account or has taken more than one loan from the banker, the banker can appropriation these loans by the accounts.

➢ **Right to Charge Interest and Commission**

The bank has the implied right to charge interest on loans and advances and 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.

As a creditor, a banker has the implied right to charge interest on the loans granted to the customer. In the same way, incidental charges like service charges, processing fees, appraisal charges, panel charges may be imposed by the banker on the customer.

Deposit are repayable on the term and made by the customer. Still, the period of limitation for the refund of bank deposit is three years with effect from the date a customer made a demand for his money.

➢ **Right to Close the Account**

If the bank believes 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 cannot close any customer's account.

## 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 its customers are;

❖ The obligation of bankers to honor checks.
❖ The obligation of bankers to maintain secrecy.
❖ The obligation of bankers is to maintain proper records.
❖ The obligation of bankers to follow customer's instructions.
❖ The obligation of bankers to give notice before closing the account.

- **Obligation of Banker to Honor Checks**

The bank has a statutory obligation to honor the checks/cheques of its customers up to the amount standing to the credit of the customer's account.

- **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.

- **Obligation of Banker to Maintain Proper Records**

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

- **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 a contractual relationship between the bank and the customer.

- **Obligation of Banker to give Notice before Closing the Account**

If a banker wishes to close the customer's account, it must give reasonable notice to this effect to the customer. Thus, a bank cannot close a customer's account on its own wish because it may have serious consequences to the customer.

**5. What are the salient features of Reserve Bank of India Act, 1934? How it governs the banking system in India?**

The Reserve Bank of India (RBI) is the apex financial institution of the country's financial system entrusted with the task of control, supervision, promotion, development and planning. RBI is the queen bee of the Indian financial system which influences the commercial banks' management in more than one way.

The RBI influences the management of commercial banks through its various policies, directions and regulations. Its role in bank management is quite unique. In fact, the RBI performs the four basic functions of management, viz., planning, organizing, directing and controlling in laying a strong foundation for the functioning of commercial banks.

## Objective and Establishment of RBI

**Important aspects relating to objectives of the Reserve Bank of India (RBI) are as follows:**

**(1) Primary objects:** Preamble to the RBI Act, 1934 spells out the objectives of the RBI as:

(*a*) To regulate the issue of bank notes.

(*b*) To keep reserves with a view to securing monetary stability in India.

(*c*) To operate currency and credit system of the country to its advantage.

Prior to the establishment of the RBI, the Indian financial system was totally inadequate on account of the inherent weakness of the dual control of currency by the Central Government and of credit by the Imperial Bank of India. The Hilton-Young Commission, therefore, recommended division of functions and responsibility for control of currency and credit and the divergent policies by setting-up of a central bank called the RBI – which would regulate the financial policy and develop banking facilities throughout the country. Hence, the RBI was established with this primary object in view.

**(2) Remain free from political influence:** Another objective of the RBI has been to remain free from political influence and be in successful operation for maintaining financial stability and credit.

**(3) Fundamental objects:** Fundamental object of the RBI is to discharge purely central banking functions in the Indian money market *i.e.* to act as –

(*a*) Note-issuing authority

(*b*) Bankers' bank

(*c*) Banker to government

**(4) Promote the growth of the economy:** RBI aims to promote the growth of the economy within the framework of the general economic policy of the Government, consistent with the need of maintenance of price stability.

**(5) Development of Indian Economy:** A significant object of the RBI has also been to assist the planned process of development of the Indian economy. Besides the traditional central banking functions, with the launching of the 5 year plans in the country, the RBI has been moving ahead in performing a host of developmental and promotional functions, which are normally beyond the purview of a traditional Central Bank.

### Functions of RBI

Various functions of RBI under the RBI Act, 1934 are as follows:

- Banking Functions
- Issue bank notes
- Monetary Policy Functions
- Public Debt Functions
- Foreign Exchange Management

- Banking Regulation & Supervision
- Regulation and Supervision of NBFCs
- Regulation & Supervision of Co-operative banks
- Regulation of Derivatives and Money Market Instruments
- Payment and Settlement Functions
- Consumer Protection Functions
- Financial Inclusion and Development Functions

## UNIT-II

**13 MARKS:**

1. **Explain the different types of risks faced by a banker with the help of examples. Suggest Measures to mitigate them.**

   **Meaning of risk:**

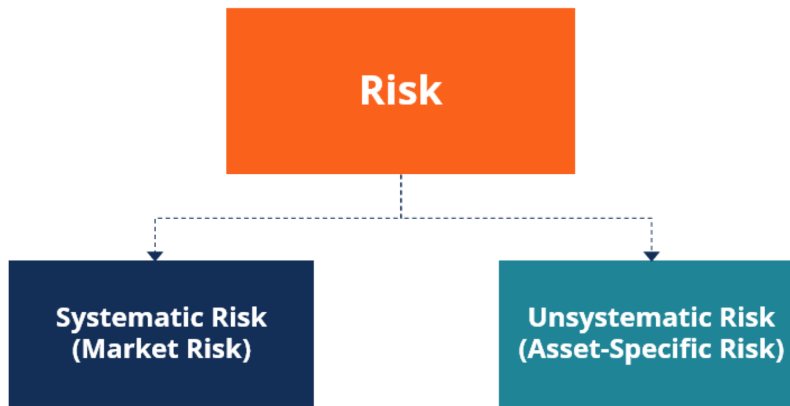
   In finance, risk is the probability that actual results will differ from expected results. In the Capital Asset Pricing Model (CAPM), risk is defined as the volatility of returns. The concept of "risk and return" is that riskier assets should have higher expected returns to compensate investors for the higher volatility and increased risk.

   Types of Risk

   Broadly speaking, there are two main categories of risk: systematic and unsystematic. Systematic risk is the market uncertainty of an investment, meaning that it represents external factors that impact all (or many) companies in an industry or group. Unsystematic risk represents the asset-specific uncertainties that can affect the performance of an investment.

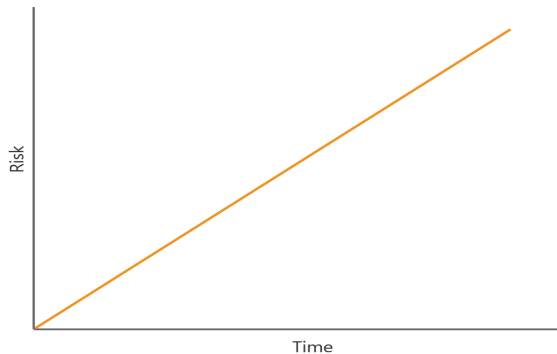
   Below is a list of the most important types of risk for a financial analyst to consider when evaluating investment opportunities:

   - **Systematic Risk** – The overall impact of the market
   - **Unsystematic Risk** – Asset-specific or company-specific uncertainty
   - **Political/Regulatory Risk** – The impact of political decisions and changes in regulation
   - **Financial Risk** – The capital structure of a company (degree of financial leverage or debt burden)
   - **Interest Rate Risk** – The impact of changing interest rates
   - **Country Risk** – Uncertainties that are specific to a country
   - **Social Risk** – The impact of changes in social norms, movements, and unrest
   - **Environmental Risk** – Uncertainty about environmental liabilities or the impact of changes in the environment
   - **Operational Risk** – Uncertainty about a company's operations, including its supply chain and the delivery of its products or services
   - **Management Risk** – The impact that the decisions of a management team have on a company
   - **Legal Risk** – Uncertainty related to lawsuits or the freedom to operate
   - **Competition** – The degree of competition in an industry and the impact choices of competitors will have on a company




**Time vs. Risk**

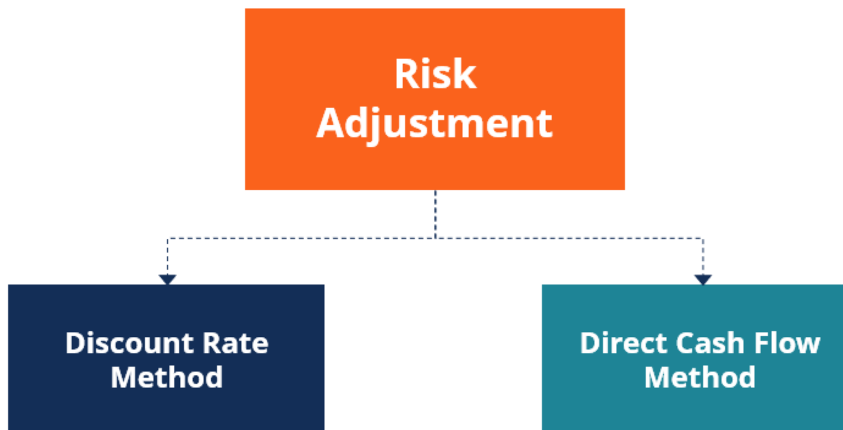
The farther away into the future a cash flow or an expected payoff is, the riskier (or more uncertain) it is. There is a strong positive correlation between time and uncertainty.




Below, we will look at two different methods of adjusting for uncertainty that is both a function of time.

## Risk Adjustment

Since different investments have different degrees of uncertainty or volatility, financial analysts will "adjust" for the level of uncertainty involved. Generally speaking, there are two common ways of adjusting: the discount rate method and the direct cash flow method.




### #1 Discount Rate Method

The discount rate method of risk-adjusting an investment is the most common approach, as it's fairly simple to use and is widely accepted by academics. The concept is that the expected future cash flows from an investment will need to be discounted for the time value of money and the additional risk premium of the investment.

### #2 Direct Cash Flow Method

The direct cash flow method is more challenging to perform but offers a more detailed and more insightful analysis. In this method, an analyst will directly adjust future cash flows by applying a certainty factor to them. The certainty factor is an estimate of how likely it is that the cash flows will

actually be received. From there, the analyst simply has to discount the cash flows at the time value of money in order to get the net present value (NPV) of the investment. Warren Buffett is famous for using this approach to valuing companies.

### Risk Management

There are several approaches that investors and managers of businesses can use to manage uncertainty. Below is a breakdown of the most common risk management strategies:

#### #1 Diversification

Diversification is a method of reducing unsystematic (specific) risk by investing in a number of different assets. The concept is that if one investment goes through a specific incident that causes it to underperform, the other investments will balance it out.

#### #2 Hedging

Hedging is the process of eliminating uncertainty by entering into an agreement with a counterparty. Examples include forwards, options, futures, swaps, and other derivatives that provide a degree of certainty about what an investment can be bought or sold for in the future. Hedging is commonly used by investors to reduce market risk, and by business managers to manage costs or lock-in revenues.

#### #3 Insurance

There is a wide range of insurance products that can be used to protect investors and operators from catastrophic events. Examples include key person insurance, general liability insurance, property insurance, etc. While there is an ongoing cost to maintaining insurance, it pays off by providing certainty against certain negative outcomes.

#### #4 Operating Practices

There are countless operating practices that managers can use to reduce the riskiness of their business. Examples include reviewing, analyzing, and improving their safety practices; using outside consultants to audit operational efficiencies; using robust financial planning methods; and diversifying the operations of the business.

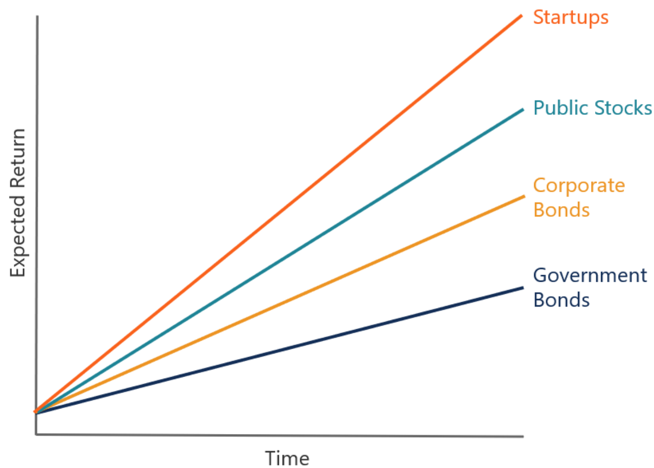
#### #5 Deleveraging

Companies can lower the uncertainty of expected future financial performance by reducing the amount of debt they have. Companies with lower leverage have more flexibility and a lower risk of bankruptcy or ceasing to operate.

It's important to point out that since risk is two-sided (meaning that unexpected outcome can be both better or worse than expected), the above strategies may result in lower expected returns (i.e., upside becomes limited).

### Spreads and Risk-Free Investments

The concept of uncertainty in financial investments is based on the relative risk of an investment compared to a risk-free rate, which is a government-issued bond. Below is an example of how the additional uncertainty or repayment translates into more expense (higher returning) investments.




As the chart above illustrates, there are higher expected returns (and greater uncertainty) over time of investments based on their spread to a risk-free rate of return.

## Effective Risk Mitigation Strategies:

Identifying risk is an important first step. It is not sufficient though.

Taking steps to deal with risk is an essential step. Knowing about and thinking about risk is not the same as doing something about risk.

Risk will occur. Some good, some bad. Some minor, some catastrophic. Your ability to mitigate risk allows you to proactively acknowledge and accommodate risks. Let's talk about four different strategies to mitigate risk: avoid, accept, reduce/control, or transfer.

- **Avoidance**

If a risk presents an unwanted negative consequence, you may be able to completely avoid those consequences. By stepping away from the business activities involved or designing out the causes of the risk you can successfully avoid the occurrence of the undesired events.

One way to avoid risk is to exit the business, cancel the project, close the factory, etc. This has other consequences, yet it is an option.

Another approach is to establish policies and procedures that assist the organization to foresee and avoid high-risk situations. By not starting a project that includes a high unwanted risk successfully avoids that risk.

- **Acceptance**

Every product produced has a finite chance of failing in the hands of your customer. When that risk is at an acceptable level, sufficiently low estimated field failure rate, then ship the product. Accept the risk.

When the decision to accept the risk is in part based on an estimate or prediction, there is the risk the information incorrectly forecasts the future. Therefore, for high consequence related field failures, closely monitoring field performance or establishing early warning systems may be prudent.

- **Reduction or control**

FMEA, hazard analysis, FTA, and other risk prioritization tools focus help you and your organization identify and prioritize risks. Reducing the probability of occurrence or the severity of the consequences of an unwanted risk (say product failure) is a natural outcome of risk prioritization tools.

Controls may focus on management or decision-making processes. Improving the ability to find design flaws or to improve the accuracy of field failure rate prediction both improve the ability to make the appropriate decisions concerning risk.

- **Transference**

This strategy is to shift the burden of the risk consequence to another party. This may include giving up some control, yet when something goes wrong your organization is not responsible.

This approach may not work to protect your brand image if the product is associated with your organization. Even if the power supply vendor pays for all damages due to failures in their unit, the customer only knows that your product has failed and caused damage. Use this approach with caution.

2. **Discuss the lending functions of banks. Explain different types of lending.**
   Lending (also known as "financing") occurs when someone allows another person to borrow something. Money, property, or another asset is given by the lender to the borrower, with the expectation that the borrower will either return the asset or repay the lender.

## Functions of lending:

This function is very important because the economic development of the country mainly depends on the credit schemes of banks. Banks lend money in different forms. They can be either secured or unsecured. The most popular forms of lending are:

1. Overdraft.
2. Cash Credits.
3. Loans and Advances.
4. Discounting of Bills of Exchange.

1. Overdraft

An overdraft is an arrangement by which the customer is permitted to draw money over and above the credit balance in his account. This facility is provided only to holders of current accounts. It is granted against some collateral security. However the customers have to pay interest for the overdrawn amount.

2. Cash Credit

Cash credit is a short-term credit given to the businessmen for meeting their working capital requirements. It is normally made against certain security. Entire amount of loan will not be given at one particular time. The banker opens the cash credit account in the name of the borrower and permits him to withdraw money from time to time up to a certain limit fixed by the value of stocks kept in the go-down of the borrower.

3. Loans and Advances

These are direct loans given to all type of customers. These loans are given against the security of the movable and immovable properties. The amount of loan is paid as cash, or customer's account is credited with it so that he can withdraw the amount from his account at any time. The interest is charged on the full amount of the loan irrespective of the amount of cash withdrawn by him.

4. Discounting of Bills of Exchange

Discounting of bills of exchange is another type of lending by the modern banks. If the holder of bill of exchange needs money immediately, he can get it discounted by the bank. The bank pays the value of the bill to the holder after deducting its commission. When the bill matures, the bank gets payment from the party, which had accepted the bill. By discounting the bills, the banker actually converts a future claim into present money, which enables the holder to carry on his business smoothly. The banker should protect himself against bogus bills. Otherwise he will incur a heavy loss.

**Types of lending:**

i) **Fund based lending**
- Loans
- Cash credit
- Overdraft
- Bills purchase and discounted

ii) **Non-fund based lending**
- Bank guarantees
- Letter of credit

iii) **Asset based lending**
- Project finance

- Securitization

➢ **Fund based lending:**

Fund-based credit limits are financial products that a bank or lender will give that allows businesses to physically draw funds out of their accounts. Fund-based working capital includes funding such as:

- Short term loans
- Cash credit or business overdrafts
- Term loans for fixed assets

Businesses typically use fund-based credit limits to gain quicker access to cash to help address things like cash flow problems or even stock.

➢ **Non-fund based lending:**

Non-fund-based finance isn't physical fundings but more of a promise of financial support compared to actual funds. Non-based-credit limits include:
a bank guarantee
letter of credit.

- A bank guarantee is a guarantee from lenders that ensures the debtor will be able to repay the debt. If they can't settle it, the bank covers it. A letter of credit is a legal document a bank can present that outlines payment will be made back by the business.
- A non-based credit limit allows businesses to use funds to help grow and develop their business without physical finance. The guarantee still lets a business buy equipment or draw down loans and expand activity without having to handle the funds.
- Both types of working capital enable businesses to grow and invest in their activities to help improve the company's day-to-day running. This type of finance is becoming more popular with all kinds of businesses and whilst not all high street lenders or banks can offer businesses either fund-based and non-fund-based credit facilities, there is an increasing number of lenders that are able to.

**3. Explain different types of loans and advances in details.**

**Introduction:**

Loan refers a formal agreement between a bank and borrower to provide a fixed amount of credit for a specific time period. A loan is **when money is given to another party in exchange for repayment of the loan principal amount plus interest**. Lenders will consider a prospective borrower's income, credit score, and debt levels before deciding to offer them a loan.

**Types of loan:**

Types of Loans

Loans can be classified further into secured and unsecured, open-end and closed-end, and conventional types.

1. Secured and Unsecured Loans

A secured loan is one that is backed by some form of collateral. For instance, most financial institutions require borrowers to present their title deeds or other documents that show ownership of an asset, until they repay the loans in full. Other assets that can be put up as collateral are stocks, bonds, and personal property. Some common attributes of secured loans include lower interest rates, strict borrowing limits, and long repayment periods. **Examples of secured borrowings are a mortgage, boat loan, and auto loan.**

Conversely, an unsecured loan means that the borrower does not have to offer any asset as collateral. With unsecured loans, the lenders are very thorough when assessing the borrower's financial status. This way, they will be able to estimate the recipient's capacity for repayment and decide whether to

award the loan or not. **Unsecured loans include items such as credit card purchases, education loans, and personal loans.**

2. Open-End and Closed-End Loans

A loan can also be described as closed-end or open-end. With an open-ended loan, an individual has the freedom to borrow over and over. Credit cards and lines of credits are perfect examples of open-ended loans, although they both have credit restrictions. A credit limit is the highest sum of money that one can borrow at any point.

With closed-end loans, individuals are not allowed to borrow again until they have repaid them. As one makes repayments of the closed-end loan, the loan balance decreases**. Examples of closed-end loans are a mortgage, auto loans, and student loans.**

3. Conventional Loans

The term is often used when applying for a mortgage. It refers to a loan that is not insured by government agencies such as the Rural Housing Service (RHS).

Things to Consider Before Applying for a Loan

For individuals planning to apply for loans, there are a few things they should first look into. They include:

1. Credit Score and Credit History

If a person has a good credit score and history, it shows the lender that he's capable of making repayments on time.

2. Income

Before applying for any kind of loan, another aspect that an individual should evaluate is his income. For an employee, they will have to submit pay stubs, W-2 forms, and a salary letter from their employer.

3. Monthly Obligations

In addition to their income, it's also crucial that a loan applicant evaluates their monthly obligations. Lenders may not be willing to give loans to such people.

## Advantages of loan:

- **Flexibility:** A bank loan allows one to repay as per convenience as long as the instalments are regular and timely. Unlike an overdraft where all the credit is deducted in go. Or a consumer credit card where the maximum limit cannot be utilised in one go.
- **Cost Effectiveness:** When it comes to interest rates, bank loans are usually the cheapest option compared to overdraft and credit card.
- **Profit Retention:** When you raise funds through equity you have to share profits with shareholders. However, in a bank loan raised finance you do not have to share profits with the bank.
- **Benefit of Tax:** Government makes the interest payable on the loan a tax-deductible item when the loan has been taken for business purpose.

4. **Explain the various sources of bank funds. Explain the recent strategies adopted in pricing of deposit services.**

**Transaction (Payments or Demand) Deposits**

A transaction deposit is an account used primarily to make payments for purchases of goods and services. The financial-service providers must instantly honor whatever withdrawals a customer makes in person, or by a third party chosen by the customer to be the recipient of funds withdrawn.

Transaction deposits are further divided into noninterest-bearing transaction deposits and interest-bearing transaction deposits.

- **Noninterest-bearing demand deposits:** offer customers payment services, safekeeping of funds, and recordkeeping for any transactions committed by card, check, or an electronic network. They are the most volatile and unpredictable source of funds.
- **Interest-bearing demand deposits:** offer all the services provided by noninterest-bearing demand deposits and pay interest to the depositor. Additionally, they give the depository institution the right to ensure a prior notice before any withdrawal of funds by customers. They are subdivided into:

- Negotiable orders of withdrawal (NOW) accounts;
- Money market deposit (MMDA) account; and
- Super NOW (SNOW) account.

**II. Non-transaction (Savings or Thrift) Deposits)**

Savings or thrift deposits have features that attract funds from customers who wish to reserve money in expectation of future expenditures or for financial emergencies. In other words, a thrift account is an account whose primary purpose is to encourage the bank customer to save rather than make payments. Compared to transaction deposits, non-transaction deposits usually pay substantially higher interest rates and are less costly to process and manage for the offering institutions.

**Non-transaction deposits are split into:**

- **Passbook savings deposits:** pay the depositor a competitive interest rate. A physical notebook, called a passbook, accompanies the depositor to monitor (track) the flow of funds into and out of the account.
- **Statement savings deposits:** include transactions involving deposits, withdrawals, and interest earned, which are recorded as computer entries. The depositor receives a regular statement of account, showing all transactions up to the posting date. However, unlike passbook savings deposits, the depositor does not receive a passbook evidencing ownership of the account.
- **A time deposit:** also known as a certificate of deposits in the United States, is a bank deposit that has a specified period to maturity and bears interest. This deposit cannot be withdrawn for a specific term unless a penalty is paid.

**III. Retirement Savings Deposits**

Retirement savings deposits can be categorized into three:

- **Individual retirement account (IRA):** Salaried and wage-earning individuals make tax free and limited contributions each year to this account type, offered by depository institutions, brokerage firms, insurance companies, and mutual funds, or by employers with a qualified pension or profit-sharing plans.
- **Keogh Plan:** Self-employed individuals or businesses have access to a tax-deferred pension plan called a Keogh Plan for retirement purposes. It can either be a defined benefit or a defined contribution plan.
- **Roth IRA:** This is a retirement savings account that is tax-advantaged. In other words, it permits an individual to withdraw their retirement savings tax-free.

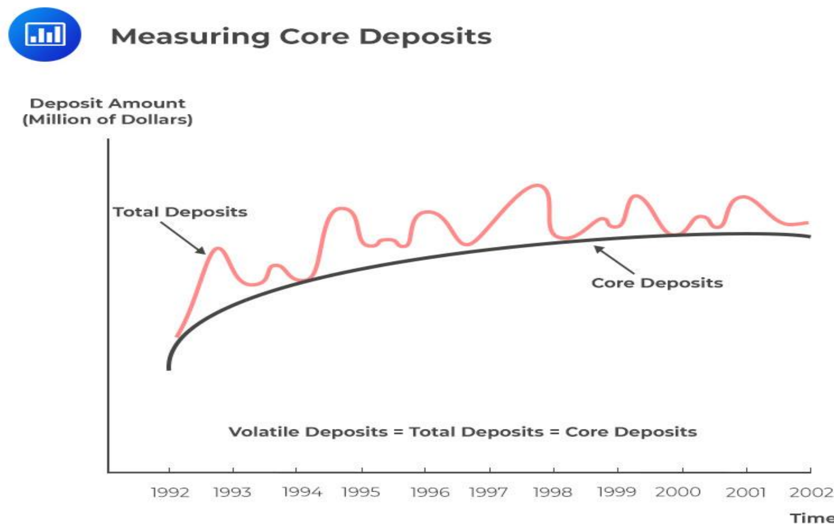
The main difference between Roth IRAs and traditional IRAs is that Roth IRAs are financed with after-tax dollars. This means that the contributions are not liable to tax-deductions, but once one starts withdrawing funds, the money is tax-free. Conversely, traditional IRA deposits are made with pre-tax dollars. This implies that an individual is liable to a tax deduction on their contribution and consequently pays income tax when they take out money from the account when they retire.

**Interest rates on deposits majorly depend on:**

- The maturity of the deposit;

- The size of the depository financial institution;
- The risk of the depository institution; and/or
- The marketing philosophy and goals of the depository institution.

**Core deposits** are a stable base of funds that are not highly sensitive to market interest rate fluctuations and which tend to remain with the bank. The following figure illustrates the core deposits.




Methods Used to Determine the Pricing of Deposits and Calculation of the Price of a Deposit Account

The main goal of depository institutions is to price their deposit services in a way that attracts new funds and makes a profit.

**<u>Sources Of Banks Funds:</u>**

A bank is a business firm. Its main aim is to earn profit. In order to achieve this objective it provides services to the customers. It offers a variety of interest bearing obligations to the public. These obligations are the sources of funds for the bank and are shown on the liability side of the balance sheet of a commercial bank. The main sources which supply funds to a bank are as follows:

A Bank's Own Funds.
B Borrowed Funds.

1. **Bank's own funds.**

Bank's own funds are mainly of three types;

(a) Paid up capital.

(b) Reserve fund.

(C) Portion of undistributed profit.

**(A) Banks Own Funds.**

**1. Paid up capital**

Bank's own paid up capital. The amount with which a banking company is registered is called nominal or authorized capital. It is the maximum amount of capital which is mentioned in the capital clause of the memorandum of association of the company. Capital is further divided into (i) paid up capital and (ii) subscribed capital.

**2. Reserve fund.**

Reserve is another source of fund which is maintained by all commercial banks. At the time of declaring dividend, a certain portion of the profit is transferred to the reserve fund. This reserve belongs to the .shareholders and at the time of liquidation, the Shareholders are entitled to these reserves along with the capital.

**3. Profit.**

Profit is another source to a bank for the purpose of business. Profits signify the credit balance of the profit and loss account which has not been distributed.

**(B) Borrowed Funds.**

The borrowed capital is a major and an important source of fund for any banking business. It mainly comes from deposits which are accepted on varying terms in different accounts. Bank's borrowing is mostly in the form of deposits. Bank collects three kinds of deposits from its customers (1) current or demand deposits (2) saving deposits and (3) fixed or time deposits. The larger the deposits of bank, the larger will be its (use) fund for employment and so higher are its profit.

**1. Borrowing from central bank.**

The commercial banks in times of emergency borrow loans from the central bank of the country. The central bank extends help as and when financial help is required by the commercial banks.

**2. Other sources.**

Bank also raise funds by issuing bonds, debentures, cash certificates etc. etc. Though it is not common but is a dependable source of borrowing.

- Bonds
- Debenture
- Cash certificates

**3. Deposits.** Public deposits are a powerful source of funds to a bank. There are' three types of bank deposits

(i) current deposits
(ii) saving deposits
(iii) time deposits.

Due to the spread of literacy, banking habits and growth in the volume of business operations, there is a marked increase in deposit money with banks.

**Factors determine the cost of sourcing of bank funds :**

**1**) Cost of funds
2) Cost Interest Rate Risk
3) Spread
4) Level of technology
5) Nature of Deposit

**5. (i) Explain the need for credit monitoring.**
**(ii) Should rehabilitation be done on a continuous basis? Explain the procedure for rehabilitation of sick units.**

**i) Need for credit monitoring:**

Credit Monitoring is the tacking of an individual's credit history, for any changes or suspicious activities. A credit monitoring service is will show an individual's credit report provide them with new information regarding new credit inquiries, accounts etc.

- It provides individuals with reports if any changes occur on their history, with also provides your score and report.
- With credit monitoring, the possibility of credit fraud and identity theft is curtailed due to monitoring.
- Alerts provided to the individuals on their important activities, such as credit history, credit inquires, delinquency, records of public nature, and even any other negative information.

➢Prevention is better than cure;

➢To avoid slippage of accounts into NPA;

➢To ensure end use of funds;

➢To ensure compliance of terms of sanction;

➢Banking is depending on projections, assumptions, estimates, hence monitoring of advance is essential;

➢A good sanction can become bad if not properly disbursed & supervised; ➢Stitch in time saves nine;

➢Credit monitoring has become most important in view of system driven NPAs & growing NPAs;

➢To guard against the human tendency to deviate from the stipulated terms in case of necessity, which, is particular, exists in case of advances.

**ii) Procedure for rehabilitation of sick units:**

Rehabilitation is founded on the philosophy that every person has the right to be in charge of their health and that they also have inherent worth. This philosophy results in the viewpoint of every individual as being a comprehensive, holistic and unique entity.

**Stage1:** To formulate a viability plan for the company. For this purpose the investment banker has to understand the business model, future business opportunities and the resulting cashflow therefrom.

**Stage2:** The 'Debt Re-structuring Scheme' has to comply with statutory norms and applicable guidelines issued by the RBI.

**Stage3:** To present the DRS to lenders and represent the client in discussions and negotiations with the consortium of lenders or individual lenders as the case may be.

## UNIT-III

**13MARKS:**

**1. Elaborate the E-payment system used by bank in India.**

- Electronic Payment Systems in India

Money can be transferred from one person to another electronically through various electronic payment systems in India. The initiatives and steps taken by the Reserve Bank of India has created a strong technology based system for electronic payments, allowing seamless electronic fund transfer between two parties with very minimal transaction cost. In this article, we look at the different types of electronic payment systems currently operational in India.

- Electronic Clearing Service (ECS)

ECS payment was introduced in India by the RBI during the 1990s. Since, its introduction, the platform has grown more robust and scaled to handle large volumes. ECS payments are used to

handle bulk and repetitive payment like salary, interest, dividend payments of companies, corporates and institutions. Using ECS payment system, a customer accounts can be credited on a specified date for a specific amount.

- National Electronic Funds Transfer (NEFT)

The NEFT payment system was introduced in 2005 to facilitate one to one fund transfers. NEFT payment system can be used by both individuals and corporates. NEFT system processes payments in batches at hourly intervals, thus providing near real-time settlement of funds from one party to another. There is no minimum of maximum limit on the amount of funds that can be transferred through NEFT.

- National Electronic Clearing Service (NECS)

During September 2008, the Bank launched a new service known as National Electronic Clearing Service (NECS), at National Clearing Cell (NCC), Mumbai. NECS (Credit) facilitates multiple credits to beneficiary accounts with destination branches across the country against a single debit of the account of the sponsor bank. The system has a pan-India characteristic and leverages on Core Banking Solutions (CBS) of member banks, facilitating all CBS bank branches to participate in the system, irrespective of their location across the country.

- Real Time Gross Settlement (RTGS)

In the RTGS system, funds are transferred from one bank account holder to another on a “real time” and on “gross” basis. Settlement in the RTGS system happens “Real Time” on a one on one basis and there is no bunching or batching like the NEFT system, wherein payments are processed in batches. Once a payment is processed through the RTGS system, it cannot be undone and is final and irrevocable. RTGS system has been operational since 2004 and is used for settling inter-bank payments.

- Regional ECS (RECS)

Similar to NECS, RECS operates as a miniature of NECS confined to the bank branches within the jurisdiction of a Regional office of RBI. RECS system is available in Ahmadabad, Bangalore, Chennai and Kolkata regions. Under the system, the sponsor bank will upload the validated data through the Secured Web Server of RBI containing credit/debit instructions to the customers. The RECS centre will process the data, arrive at the settlement, to provide credit/debit to the accounts of beneficiaries by using the Core Banking System put in place by the bank.

- Electronic Clearing Service (ECS) Debit

ECS (Debit) system helps with effecting periodic and repetitive collections of bills from consumers. ECS (Debit) facilitates consumers to subscribe to services of companies and make routine and repetitive payments by ‘mandating’ bank branches to debit their accounts and pass on the money to the companies. There is no limit on the minimum or maximum amount of payment through the ECS debt system.

- Electronic Funds Transfer (EFT)

The Electronic Funds Transfer system was introduced in the late 1990s to enable account holders of a bank to electronically transfer funds to another account holder. The EFT system has gradually been phased out for use by the general public and subsumed by the National Electronic Funds Transfer (NEFT) system.

Let us see what are the main advantage as well as disadvantages of this payment method.

**Advantages**:

1. **Increased speed**:

We do not have to worry about carrying paper money or wait in line to withdraw money from ATMs. Through E-payments you can pay anyone at any time.

2. **Increased Sales**:

As people are able to pay to anyone and are not much dependant, the demands of products in the market have increased which resulted to increase in sales of almost every product.

3. **Instant Receipts**:

As soon as you make an online payment, you receive receipts and feedback almost instantly.

4. **Better Deals**:

As people are getting more indulged in e-payments, almost every payment service provider has started giving exciting offers helping people get good deals.

**Disadvantages**:

1. **Service Fees**:

Many a time while using e-payment services we are liable to pay service fees or a convenience fee which adds to our expense.

2. **Risk of Theft**:

There have been many incidents in which cybercriminals have manipulated people and money has been looted.

3. **Technical Problems**:

As it is an online service, it may go down due to technical issues and people who get 100% reliable on this service for their payments may face an issue.

4. **Remote Areas**:

Remote areas still rely on cash. You might find it difficult in making payments on the go while traveling to some remote areas.

2. **Explain the working of ATMs. Also describe the forecasting of cash demand at ATMs.**

Cash demand in ATMs require accurate prediction which is no different than in other vending machines. The only difference is the product which is cash needs to be replenished for a priory set period of time. If the forecast is wrong, it induces a considerable amount of costs. In the case of high forecast and high unused cash stored in the ATM incur costs to the bank. The bank pays different re-filling costs depending on its policy with the money transportation company.

**Business use-case**

ATMs should not be filled with large amounts of cash which may bring low transport/logistics cost but high freezing & high insurance costs. On the other hand, if banks do not have the proper mechanism to track the usage pattern, then frequent re-filling ATMs will reduce freezing and insurance cost but increase logistics cost.

**Data loading**

We have daily transactions data from 2011 till 2017. The actual withdrawals (total_amount_withdrawn) includes all the transactions where the actual amount is withdrawn from the ATM. These are the transactions which actually reflect in the available balance in the ATM machine.

**Modeling Daily Cash Demand**

We will try fitting several time series models and find the best fitted model for our data, which would allow forecasting of future demand. A lot of machine learning models are available to choose from and deciding where to start can be intimidating.

**OneHotEncoding**

The following code snippet separates the numeric features, selects the categorical features and use one-hot encode on these features, and joins the two sets together. This sounds like complex work, but it is relatively simple and straightforward.

**Light GBM**

LightGBM offers good accuracy with integer-encoded categorical features. It often performs better than one-hot encoding.

For multiple teller machines, the use of cluster-wise cash demand prediction can be done which comes with added advantages:

improved accuracy of the cash demand forecasts due to reduction in computational complexity when predicting an ATMs daily cash demand for groups of ATM centers with similar day-of-the week cash withdrawal seasonality patterns,

potentially huge savings in operational costs as similar cash replenishment models can be used for ATM centers belonging to the same cluster.

**Conclusion**

LightGBM and CatBoost have shown good prediction power without any optimization with the given data set. However, there are quite a few financial institution and use cases are available where either simple linear regression or complex neural networks are being used for such cases. When we solve a business problem, being an analytics consultant, the 1st question comes to our mind is whether we can solve using Linear Programming (LP).

3. **Explain the importance of E-banking system in India. Describe how Indian customers are reacting to E-banking post demonetization?**

**E-Banking**

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

**Therefore, banking websites are of two types:**

**Informational Websites** – These websites offer general information about the bank and its products and services to customers.

**Transactional Websites** – These websites allow customers to conduct transactions on the bank's website. Further, these transactions can range from a simple retail account balance inquiry to a large business-to-business funds transfer. The following table lists some common retail and wholesale e-banking services offered by banks and financial institutions:

**Common E-Banking Services**

| Retail Services | Wholesale Services |
|---|---|
| Account management | Account management |
| Bill payment | Cash management |
| New account opening | Small business loan applications, approvals, or advances |
| Consumer wire transfers | Commercial wire transfers |
| Investment / Brokerage services | Business-to-business payments |
| Loan application and approval | Employee benefits / pension administration |
| Account aggregation | |

**Importance of e-banking**

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

**Banks**

**Lesser transaction costs** – electronic transactions are the cheapest modes of transaction

A reduced margin for human error – since the information is relayed electronically, there is no room for human error

**Lesser paperwork** – digital records reduce paperwork and make the process easier to handle. Also, it is environment-friendly.

**Reduced fixed costs** – A lesser need for branches which translates into a lower fixed cost.

More loyal customers – since e-banking services are customer-friendly, banks experience higher loyalty from its customers.

**Customers**

**Convenience** – a customer can access his account and transact from anywhere 24x7x365.

Lower cost per transaction – since the customer does not have to visit the branch for every transaction, it saves him both time and money.

**No geographical barriers** – In traditional banking systems, geographical distances could hamper certain banking transactions. However, with e-banking, geographical barriers are reduced.

**Businesses**

**Account reviews** – Business owners and designated staff members can access the accounts quickly using an online banking interface. This allows them to review the account activity and also ensure the smooth functioning of the account.

**Better productivity** – Electronic banking improves productivity. It allows the automation of regular monthly payments and a host of other features to enhance the productivity of the business.

**Lower costs** – Usually, costs in banking relationships are based on the resources utilized. If a certain business requires more assistance with wire transfers, deposits, etc., then the bank charges it higher fees. With online banking, these expenses are minimized.

**Lesser errors** – Electronic banking helps reduce errors in regular banking transactions. Bad handwriting, mistaken information, etc. can cause errors which can prove costly. Also, easy review of the account activity enhances the accuracy of financial transactions.

**Reduced fraud** – Electronic banking provides a digital footprint for all employees who have the right to modify banking activities. Therefore, the business has better visibility into its transactions making it difficult for any fraudsters to play mischief.

**E-banking in India**

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

**Popular services under e-banking in India**

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

**Further, under Internet banking, the following services are available in India:**

**Bill payment** – Every bank has a tie-up with different utility companies, service providers, insurance companies, etc. across the country. The banks use these tie-ups to offer online payment of bills (electricity, telephone, mobile phone, etc.). Also, most banks charge a nominal one-time registration fee for this service. Further, the customer can create a standing instruction to pay recurring bills automatically every month.

**Funds transfer** – A customer can transfer funds from his account to another with the same bank or even a different bank, anywhere in India. He needs to log in to his account, specify the payee's name, account number, his bank, and branch along with the transfer amount. The transfer is effected within a day or so.

**Investing** – Through electronic banking, a customer can open a fixed deposit with the bank online through funds transfer. Further, if a customer has a demat account and a linked bank account and trading account, he can buy or sell shares online too. Additionally, some banks allow customers to purchase and redeem mutual fund units from their online platforms as well.

**Shopping** – With an e-banking service, a customer can purchase goods or services online and also pay for them using his account. Shopping at his fingertips.

**Thus influences of demonetization are:**

• **Increase in Deposits:** Demonetization has increased the deposits in Banks. Unaccounted money in the form of Rs.500 and Rs.1000 were flowing to the Banks and the sizes of deposits have been increased. It helped the banks to grab the deposits and increase their deposits.

**Bulk of the deposits so mobilised by SCBs have been deployed in:**
(i) reverse repos of various tenors with the RBI; and (ii) cash management bills (CMBs) issued under the Market Stabilisation Scheme (which is a part of investment in government securities in the balance sheet of banks). Loans and advances extended by banks increased by Rs.1,008 billion.

• **Fall in cost of Funds:** Over the past few months, the deposits are increased. It led the banks to keep a major part of deposits in the form of cash deposits. PSU Banks have a lion share (over 70%) of the deposits and biggest gainers of the rise in deposits, leading to lower cost of funds.

• **Demand for Government Bonds:** After sharp rise in deposits on post demonetization, banks started lending such surplus deposits to the RBI under the reverse repo options. PSU Banks, particularly, deployed excess funds in government bonds. The return on bond investment is likely to add 15 to 20 per cent increase in the earnings of banks.

• **Sagginess in Lending:** Lending growth of the banks is considerably less even after demonetization and its impact of growth in the amount of public deposit. Banks have tried to lend the money to the needy group by reducing their interest rates, but it shrunk over the last few months.

**4. What are the objectives of mergers in banking sector? Critically analyze on the mergers that have taken place in the post liberalization era.**

**Meaning of Merger;**

The merger is the process by which two or more companies decide to come together and merge together and created a new company often with a new name rather than remain separately owned and operated.

The merger helps in reducing the weakness and get a competitive edge in the market. In the merger process, the merging companies share information related to debt, resources, technology, and assets, etc. With each other

**Merger Number 1: PNB+OBC+UBI**

Oriental Bank of Commerce (OBC) and United Bank of India (UBI) are merged with the Punjab National Bank (PNB). So after this merger now the PNB will be the second-largest Public Sector Banks of India after the State Bank of India in terms of the branch network.

**Merger Number 2: Syndicate Bank+ Canara Bank**

Syndicate Bank is merged with the Canara Bank. After this merger; the Canara bank would be the fourth largest Public Sector of India. The total business of Canara would be 15.20 lac crore with a branch strength of 10,342.

**Merger Number 4: Allahabad Bank + Indian Bank**

In the fourth merger, the Indian bank would be merged with the Allahabad Bank. after the merger, Allahabad bank would be the 7th largest Public Sector Bank of India.

**Objectives of mergers in banking sector:**

**1.** After these mergers, the lending capacity of the Public Sector Banks will increase and their balance sheet would also be strong.

**2.** These big banks would also be able to compete globally and increase their operational efficiency by reducing their cost of lending.

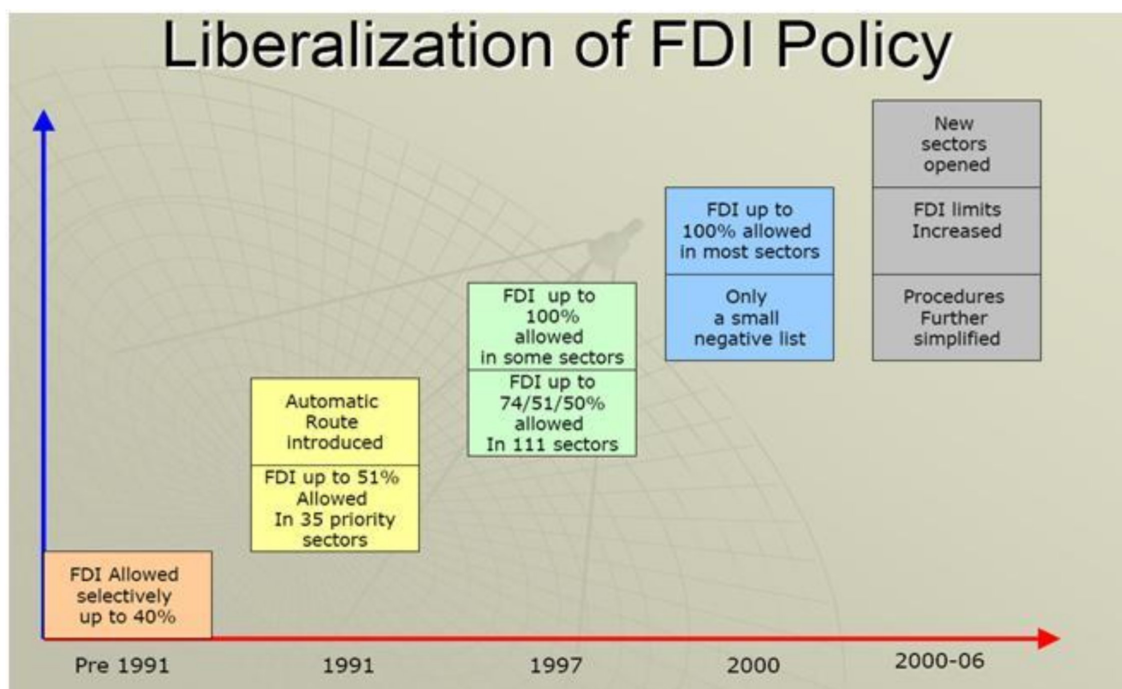
**3.** India needs investment in huge quantities to turned India into a 5 trillion economy. If banks have sufficient money to fund big projects than the economic development of the country would speed up.

**4.** The merger would help in better management of banking capital.

So after the merger of the 10 PSBs in the four major banks seems a good step in ensuring the availability of the money for the investment purpose in the country.

**Objectives of Mergers and Acquisitions**

- To create a more cost-efficient operation
- To expand a firm's geographic coverage
- To extend a firm's business into new product categories or international markets




5. **Illustrate the features, types and advantages of plastic money.**

Plastic money refers to these cards. Debit and credit cards represent plastic money. Plastic money has made it easier for us to carry out transactions in our daily lives. It has replaced cash payments across the world and established itself as a necessary form of instant money. It has made it simpler for us to buy items with some of the **best credit cards** in the market, which we could not otherwise afford.

**Types of plastic money**

The most common types of plastic money are debit cards, credit cards, ATM cards, and charge cards.

- Debit card

This payment card deducts funds directly from a consumer's bank deposit account to either electronically pay for goods and services or withdraw from an ATM. Debit cards are also known as bank cards or check cards. There are various types of debit cards used in different countries, but the most common include:

- Visa debit card

This is one of the most globally accepted debit cards, with an international presence of around 200+ countries. As long as the card has the visa logo, you can use it to shop, travel, and pay your utility bills directly from your bank account while you are thousands of miles away.

- MasterCard debit card:

A MasterCard is essentially used worldwide and offers 24-hour services of banking transactions in ATMs and online for booking tickets, traveling, and shopping.

Maestro Debit card

It is a debit card brand issued by MasterCard and used mainly in India and other countries. You can also use this debit card for online transactions.

- EMV cards

EMV is an abbreviation of Europay, MasterCard, and Visa. These cards have excellent security features as they use smart chip-based technology. All banks are replacing ordinary debit cards with EMV chips since they are impossible for imposers to copy data and replicate it.

- Credit cards

A credit card allows you to make transactions on loan. The bank, or credit issuer, advances money to be paid to the merchants, and you pay back later when you reach your credit limit. With this card, you can spend and then repay later. There are many types of credit cards, which are divided into two groups: Secured and unsecured.

**Secured credit cards** are issued upon paying a down payment as a security. Essentially, it is like borrowing your own money. These credit cards are primarily issued to people without a credit rating or if you do not want to have an overdraft.

**Unsecured credit cards**: The financial institution issues one without having to provide security or collateral for the credit loan. You use the credit card for various transactions and pay upon reaching the credit limit. Your credit score determines the amount the card provider will let you spend before reaching your limit and trusting that you can pay it back.

- Charge Cards

A charge card is a payment card that offers enormous credit limits to cardholders. Businesses or wealthy people with huge transactions mostly use them. Payment accrued is paid at the end of the month, and no interest is charged. However, non-payment or delayed payment usually attracts huge fines.

- ATM cards

An ATM card is a payment card issued by a bank or other financial institution to withdraw funds, majorly from an automated teller machine. Unlike the debit card, which can be used for several transactions in major stores and online transactions, an ATM card is only used to withdraw from an ATM.

- Prepaid cards

Retail and departmental stores are the leading issuers of prepaid cards. Cash is loaded on the card, and the cardholder can shop in the store without carrying cash. Upon depletion of the funds, cash can be reloaded for future use if the customer is interested.

**Benefits of plastic money**

**Plastic money comes with many benefits, including:**

1. Cashless living

Plastic money has not only made our lives easier but has also alleviated the hassles that come with carrying currency. Some of the best credit cards allow us to move around the world without worrying about carrying cash.

2. Better security

One advantage of using credit or debit cards is the decrease in robberies and crimes. Hacking a card's PIN is difficult and necessitates the knowledge of certain procedures. As a result, credit and debit cardholders can be reasonably confident of the security of their funds.

Plastic money has become a necessity today. Fortunately, the benefits outweigh the drawbacks. The ease of access and the help they provide is undeniable. Therefore, more and more people today are turning to plastic money instead of cash.

3. Financial freedom

Credit cards allow a person to make a transaction and pay for it even when they do not have the funds. It is incredibly beneficial especially when you are short on cash. Credit cards also reduce the need to rely on others for financial assistance in an emergency. You can use the credit card to fund your requirement and later payback in instalments. Further, a credit card is easy to get. All you need to do is meet your bank's **credit card** eligibility criteria, and the card is yours.

4. Ease of doing transactions

Credit cards and debit cards can help make online payments, fund transfers, and other transactions with ease. It is incredibly simple to make payments with plastic money from any location. Furthermore, several online businesses provide discounts when paying using credit and debit cards.

5. Exciting deals and discounts

Every credit and debit card providers offers deals and discounts on shopping. They can help you save more and earn cashback on purchases.

6. Saving on travel

Travelling can be expensive without plastic money. Credit and debit cards provide lounge access and incredible deals on travel bookings. You cannot enjoy the same benefits while using cash, making plastic money a must if you are travelling.

**Drawbacks of plastic money**

**Plastic money also has some downsides, such as:**

1. Does not work everywhere

There may be certain venues and stores where only cash is accepted. For example, buying products from a small merchant or buying vegetables or newspapers.

2. Can land you in debt

If a person is not careful with plastic money, they can often overstep their spending limit and spend more than they can repay. This can land them in debt.

If you are in the market for credit and debit cards and want to transition from cash to plastic money, look no further than IDFC FIRST Bank.

## UNIT-IV

**13MARKS:**

**Describe the financial services market in India.**

India's diverse and comprehensive financial services industry is growing rapidly, owing to demand drivers (higher disposable incomes, customized financial solutions, etc.) and supply drivers (new service providers in existing markets, new financial solutions and products, etc.). The Indian financial services industry comprises several key subsegments. These include, but are not limited to- mutual funds, pension funds, insurance companies, stock-brokers, wealth managers, financial advisory companies, and commercial banks- ranging from small domestic players to large multinational companies. The services are provided to a diverse client base- including individuals, private businesses and public organizations.

**10 Types of Financial Services:**

- Banking
- Professional Advisory
- Wealth Management
- Mutual Funds
- Insurance
- Stock Market
- Treasury/Debt Instruments
- Tax/Audit Consulting
- Capital Restructuring
- Portfolio Management

**These financial services are explained below:**

**1. Banking**

The banking industry is the backbone of India's financial services industry. The country has several public sector (27), private sector (21), foreign (49), regional rural (56) and urban/rural cooperative (95,000+) banks. The financial services offered in this segment include:

Individual Banking (checking accounts, savings accounts, debit/credit cards, etc.)

Business Banking (merchant services, checking accounts and savings accounts for businesses, treasury services, etc.)

Loans (business loans, personal loans, home loans, automobile loans, working-capital loans, etc.)

The banking sector is regulated by the Reserve Bank of India (RBI), which monitors and maintains the segment's liquidity, capitalization, and financial health.

**2. Professional Advisory**

India has a strong presence of professional financial advisory service providers, which offer individuals and businesses a wide portfolio of services, including investment due diligence, M&A advisory, valuation, real-estate consulting, risk consulting, taxation consulting. These offerings are made by a range of providers, including individual domestic consultants to large multi-national organizations.

**3. Wealth Management**

Financial services offered within this segment include managing and investing customers' wealth across various financial instruments- including debt, equity, mutual funds, insurance products, derivatives, structured products, commodities, and real estate, based on the clients' financial goals, risk profile and time horizons.

**4. Mutual Funds**

Mutual fund service providers offer professional investment services across funds that are composed of different asset classes, primarily debt and equity-linked assets. The buy-in for mutual fund solutions is generally lower compared to the stock market and debt products. These products are very popular in India as they generally have lower risks, tax benefits, stable returns and properties of diversification. The mutual funds segment has witnessed double-digit growth in assets under management over the last five years, owing to its popularity as a low-risk wealth multiplier.

**5. Insurance**

Financial services offerings in this segment are primarily offered across two categories:

General Insurance (automotive, home, medical, fire, travel, etc.)

Life Insurance (term-life, money-back, unit-linked, pension plans, etc.)

Insurance solutions enable individuals and organizations to safeguard against unforeseen circumstances and accidents. Payouts for these products vary across the nature of the product, time horizons, customer risk assessment, premiums, and several other key qualitative and quantitative aspects. In India, there is a strong presence of insurance providers across life insurance (24) and general insurance (39) categories. The insurance market is regulated by the Insurance Regulatory and Development Authority of India (IRDAI).

**6. Stock Market**

The stock market segment includes investment solutions for customers in Indian stock markets (National Stock Exchange and Bombay Stock Exchange), across various equity-linked products. The returns for customers are based on capital appreciation – growth in the value of the equity solution and/or dividends – and payouts made by companies to its investors.

**7. Treasury/Debt Instruments**

Services offered in this segment include investments into government and private organization bonds (debt). The issuer of the bonds (borrower) offers fixed payments (interest) and principal repayment to the investor at the end of the investment period. The types of instruments in this segment include listed bonds, non-convertible debentures, capital-gain bonds, GoI savings bonds, tax-free bonds, etc.

**8. Tax/Audit Consulting**

This segment includes a large portfolio of financial services within the tax and auditing domain. This services domain can be segmented based on individual and business clients. They include:

Tax – Individual (determining tax liability, filing tax-returns, tax-savings advisory, etc.)

Tax – Business (determining tax liability, transfer pricing analysis and structuring, GST registrations, tax compliance advisory, etc.)

In the auditing segment, service providers offer solutions including statutory audits, internal audits, service tax audits, tax audits, process/transaction audits, risk audits, stock audits, etc. These services are essential to ensure the smooth operation of business entities from a qualitative and quantitative perspective, as well as to mitigate risk. You can read more about taxation in India.

**9. Capital Restructuring**

These services are offered primarily to organizations and involve the restructuring of capital structure (debt and equity) to bolster profitability or respond to crises such as bankruptcy, volatile markets, liquidity crunch or hostile takeovers. The types of financial solutions in this segment typically include structured transactions, lender negotiations, accelerated M&A and capital raising.

**10. Portfolio Management**

This segment includes a highly specialized and customized range of solutions that enables clients to reach their financial goals through portfolio managers who analyze and optimize investments for clients across a wide range of assets (debt, equity, insurance, real estate, etc.). These services are broadly targeted at HNIs and are discretionary (investment only at the discretion of fund manager with no client intervention) and non-discretionary (decisions made with client intervention).

2. **Explain the functions and services rendered by NBFC.**

The Reserve Bank Of India has defined NBFC as the Companies which are registered under the Companies Act, 1956 and are engaged in the business of loans and advances, acquisition of shares/ stocks/ bonds/ debentures/ securities issued by Government or local authority or other marketable securities of a like nature, leasing, hire-purchase, insurance business, chit business but they do not include any institution whose principal business is that of agriculture activity, industrial activity, purchase or sale of any goods (other than securities) or providing any services related to it and sale/purchase/construction of immovable property are known as Non-Banking Financial Company. **Reserve Bank Of India has further extended the definition of NBFC as the Companies having a principal business of receiving deposits under any scheme or through any arrangement in one lump sum or in instalments by way of contributions or in any other manner.**

**Functions Of NBFC**

**Hire Purchase Services**

A hire purchase service is a way through which the seller delivers the goods to the buyer without transferring the ownership of the goods. The payment of the goods is made in instalments. Once the buyer pays all the instalments of the goods, the ownership of the good is automatically transferred to the buyer.

**Retail Financing**

Companies that Provides short term funds for Loans against shares, gold, property, primarily for consumption purposes.

**Trade finance**

Companies dealing in Dealer/distributor finance so that they can for working capital requirements, vendor finance, and other business loans.

**Infrastructural Funding**

This is the largest section where major NBFCs deal in. A lot portion of this segment alone makes up a major portion of funds lent, amongst the different segments. This majority includes Real Estate, railways or Metros, flyovers, ports, airports, etc.

**Asset Management Company**

Asset managment companies are those companies that consist of fund managers (who invest in equity shares to gain handsome gains) who invest the funds pooled by small investors and actively manage it.

**Leasing Services**

The companies that deal in leasing or for a better understanding of this word we can understand it in such a way that the way we rent a property or flat for living similarly these companies provide property to small businesses or sometimes even larger ones who cannot afford it for whatsoever reason. The only difference between renting and leasing is that leasing contracts are made for a fixed period of time.

**Venture Capital Services**

The companies that invest in small businesses are at their initial stage but their success rate is high and are promising enough of sufficient return in the coming time.

**Micro Small Medium Enterprise (MSME) Financing**

MSME is one of the roots of our economy and millions of livelihood depends on this sector that is why the government announced such luring schemes for the MSME sector to promote its growth

3. **Explain the forms and benefits of underwriting.**

The procedure through which an institution or an individual assumes a financial risk for a fee or at a preset cost is referred to as underwriting. Typically, the risk is connected with providing loans, insurance, or investments, and it is managed by in-house underwriting personnel at financial institutions.

When a substantial share of products was sent as consignments aboard ships in older times, the risk was also extremely considerable. Ship owners would document all details of the items on board to mitigate this danger. As a result, business owners would pay a premium to assume this looming risk. Underwriting became popular as a result of this.

What is the role of an underwriter?

A contract's risk-worthiness is determined by an underwriter. An underwriter in banking, for example, will assess a loan applicant's credit risk. It isn't always the most straightforward thing to do.

When the level of risk is substantially higher, underwriters may need to be more meticulous and comprehensive.

**The following are the most important responsibilities of an underwriter:**

- Examining insurance, loan, mortgage, or Initial public offering (IPO) applications
- Screening potential borrowers based on their history, assets,
- Earnings, and other characteristics
- Using risk assessment software
- Conducting investigation and reviewing materials submitted by applicants
- Accepting or rejecting applications based on research and assessments

## Types of Underwriting

Let's go through the three main sorts of underwriting: loans, insurance, and securities now that we've gone over the basic notion of underwriting and seen how it works.

### Loan Underwriting

When applying for a loan, the underwriter will look into the applicant's credit history, financial records, and the value of the collateral given at the time of application. The amount and type of loan requested will determine which aspects are checked, and the total assessment process can take anything from a few minutes to a few weeks.

Mortgage loans are the most prevalent sort of underwriting. Income, appraisal, credit score, and asset information are used by loan underwriters to assess loan payback.

Insurance Underwriting

The process of examining a potential insurance candidate for life, health and wellness, property and rental, or other types of insurance is known as underwriting.

It assesses how much coverage a person can be given, how much they should pay, and how much an insurance company is likely to pay to cover the policyholder by determining the risks of filing large or frequent claims and determining how much coverage a person can be given, how much they should pay, and how much an insurance company is likely to pay to cover the policyholder.

The potential policyholder, who is the person requesting health or life insurance, is the emphasis. The policyholder's age, health, lifestyle, medical history, occupation, family, and other criteria specified by the underwriter may be evaluated in the insurance underwriting process.

Security Underwriting

In the case of an Initial Public Offering (IPO) this is more common. This procedure assures that the company's initial public offering (IPO) will collect the necessary funds and pay the underwriters the specified premium. An investor discovers successful securities supplied by a firm pursuing an Initial Public Offering in securities underwriting (IPO).

The investor then makes a profit by selling the securities in the market. This technique allows underwriters to form an underwriter syndicate, which is a group of underwriters that acquire securities to resale. Securities underwriting is done on behalf of a potential investor or, more typically, an investment bank to determine the risk and price of a particular asset.

**How the Process of Underwriting works?**

**An underwriter considers the following four factors:**

**Appraisal**

When buying a house, appraisals are nearly always required. They safeguard both you and your lender by ensuring that you only borrow the amount that the house is genuinely worth.

Appraisals guarantee that the property or other loan purpose is worth the sought amount. In this step, an appraiser visits the property or assesses the loan's purpose to gather the required determining information, such as the investment's viability or quality.

**Income**

The term "income" refers to both gross and net income, and it is used to determine if a borrower's income is sufficient to meet the loan's monthly payment.

Your underwriter must be satisfied that you have sufficient income to cover your monthly mortgage payments. Your underwriter will also verify your job situation with your employer and check that your income matches the income you declare.

**Credit Score**

Your credit score is also assessed by an underwriter. Your credit score is a three-digit number that determines how responsible you are when it comes to debt repayment. A strong credit score demonstrates that you pay your bills on time and may qualify you for a cheaper interest rate.

The credit score you'll need depends on the type of loan you're applying for. If you apply for a conventional loan, your credit score must be at least 620.

**Asset**

Properties, federal treasury notes, corporate bonds, guaranteed investment accounts, mutual funds, and land are examples of assets that can be sold if a borrower is unable to repay their loan.

Because your assets might be auctioned for cash if you default on your payments, they can assist you secure a mortgage approval. Your bank and savings accounts, real estate, stocks, and personal items may all be examined by an underwriter.

While it is preferable to score well in all of these areas, an applicant who excels in only one or two can still be approved for a loan.

## 4. Elaborate the financial evaluation of leasing.

**Financial Evaluation of Leasing**

Once a firm has evaluated the economic viability of an asset as an investment and accepted/selected the proposal, it has to consider alternate methods of financing the investment. However, in making an investment, the firm need not own the asset. It is basically interested in acquiring the use of the asset.

Thus, the firm may consider leasing of the asset rather than buying it. In comparing leasing with buying, the cost of leasing the asset should be compared with the cost of financing the asset through normal sources of financing, i.e., debt and equity.

**The evaluation of lease financing decisions from the point of view of the lessee involves the following steps:**

(i) Calculate the present value of net-cash flow of the buying option, called NPV (B).

(ii) Calculate the present value of net cash flow of the leasing option, called NPV (L)

(iii) Decide whether to buy or lease the asset or reject the proposal altogether by applying the **following criterion:**

(a) If NPV (B) is positive and greater than the NPV (L), purchase the asset.

(b) If NPV (L) is positive and greater than the NPV (B), lease the asset.

(c) If NPV (B) as well as NPV (L) are both negative, reject the proposal altogether.

Since many financial analysts argue that the lease financing decisions arise only after the firm has made an accept-reject decision about the investment; it is only the comparison of cost of leasing and borrowing options.

**The following steps are involved in such an analysis:**

(i) Determine the present value of after-tax cash outflows under the leasing option.

(ii) Determine the present value of after-tax cash outflows under the buying or borrowing option.

(iii) Compare the present value of cash outflows from leasing option with that of buying/borrowing option.

(iv) Select the option with lower presented value of after-tax cash outflows.

(v) Evaluation:

As the present value of after-tax cash outflows under the leasing option is lesser than the present value of after-tax cash outflows of the buying option, it is advisable to take the asset on lease.

(vi) Decision if Investment Allowance is allowed:

In case Investment Allowance is allowed on purchase of asset the total of present value of net cash outflows will decrease by the present value of tax savings on investment allowance as below:

| Investment Allowance : | ₹ |
|---|---|
| (allowed at the end of 1st year) $5{,}00{,}000 \times \frac{25}{100}$ | 1,25,000 |
| Tax Savings (50%) | 62,500 |
| P.V. Factor at the end of year 1 | .847 |
| P.V. of Tax Savings on Investment Allowance | 52,938 |
| Hence, P.V. of Cash Outflows in Buying Option shall be = ₹ 2,06,684-52,938 | 1,53,746 |

In that case, the P.V. of cash outflows under buying option shall be lesser than the P.V. of cash outflows under leasing option and the company should buy the asset.

Financial Evaluation of Leasing: Way # 2.

**Lessor's Point of View:**

The financial viability of leasing out an asset from the point of view of lessor can be evaluated with the help of the two time adjusted methods of capital budgeting:

(a) Present Value Method

(b) Internal Rate of Return Method.

5. **Briefly explain the financial evaluation of hire purchase.**

**Financial Evaluation:**

It is an evaluation by the hirer of the desirability for lease and hire purchase. The hirer makes decision based on the Present Value of Net Cash Outflow. The decision is considered favorable when the PV of Net Cash Outflow under Hire Purchase is less than the PV of Net cash Outflow under leasing. **Following are the steps involved.**

Step 1 Calculate annual interest amount

Step 2 Find the principal amount outstanding at the beginning of the each year = Total outstanding principal –principal paid in the previous year.

Step 3 Find principal paid in the previous year = Annual installment amount –Annual Interest

Step 4 Find Annual ITS = Annual Interest x Tax rate
Step 5 Find Annual Depreciation

Step 6 Find Annual DTS = Annual depreciation x Tax rate

Step 7 Find Total TS = Step 4 + Step 6

Step 8 Find Annual installment amount = Total HP amount + (HP amount x flat rate of interest) / No. of HP years

Step 9 Find PV of salvage value of assets = SV x PVF

Step 10 Find Net Cash Outflow of HP = Step 8 –Step 7

**Features of Hire Purchase**

Features of Hire purchase are provided and discussed as below-

- The payment of the installments is to be done by the buyer i.e., the hirer to the seller over the specified period of time.
- Buyer gets the possession of the goods immediately.
- In case of any default of installment payment by the hirer, the vendor has the right to repossess the goods. In that case, the payment already received by the vendor from hirer will be treated as hire charged for the period for which the goods were held.
- The ownership of goods is transferred to the buyer only upon the payment of last installment.
- The hire purchase installment amount includes the principal amount as well as the interest charged upon it.
- Interest is generally charged on the flat rate

**Types of Hire Purchase**

**Types are provided and discussed as below-.**

**Consumer Hire Purchase:** In this type, the goods are hired by the buyer for non-business purposes i.e. for his personal use. This can also be for family or other household purposes apart from the business. The hirer here is not the business but the natural person.

**Industrial Hire Purchase:** Contrary to the above, here, the hirer is not the natural personal but the companies or the industries that take the goods on hire for their business purposes. Example: the hire purchase of machineries for the use in industries.

**Hire Purchase Costs**

- The total cost of hire purchase includes the fees or other charges charged by the vendor plus interest amount.
- If there is any agreement offering 0% interest, there can be other charges also which can be charged at the end of interest free period.
- Before entering into any hire purchase agreement, it is advisable to have an idea for all the fees and charges over the repayment period.
- The details of all the costs are to be given by vendor by law itself before entering into any agreement.

**Advantages and Disadvantages**

Below are the advantages and disadvantages mentioned:

- One neednot to pay the entire amount of the goods to use them. The goods can be used immediately by paying little cash initially.
- As the payment is spread over the period of time, the most expensive assets can also be easily utilized.
- With the help of hire purchase, all the future expenses are known well in advance which helps in better budgeting of finances.
- The buyer is not responsible for any depreciation on the assets. The owner .i.e. the vendor is responsible for depreciation payment.

**Disadvantages**

- As the amount of installments and the period is fixed in advance, if there exists any financial difficulty in future for the buyer and if he is unable to pay any installment, the possession of the asset is taken over by the seller.
- The cost of the asset in case of direct purchase in cash is lower than the total cost paid in hire purchase agreement as thehire purchase agreement includes the interest payment also.
- The ownership of the asset is not transferred till the payment of last installment. Hence you can't mortgage the asset in case of any bankruptcy if you face.

UNIT-V

13MARKS:

1.**Illustrate the fee based financial products and services**.

**Fee Based Banking Services**

Banks earn their income in two parts. One type of income is generated by undertaking risk i.e. by lending their deposits. This is called interest income and forms the major portion of any bank's earnings. However, **banks can also generate earnings from other sources wherein they do not have to lend money or collect interest. Such sources are called fee based banking services** and form an important part of any banks profit and loss statement. In this article we will list down the various sources from which banks can generate non interest i.e. fee based income.

**Cards**

Credit cards and debit cards have been new addition to the banks portfolios. However, in a short span of time, these services have started accounting for large sums in any bank's non interest earnings. There are a variety of fees charged by these cards. There are some fees like joining fees and annual fees. Then there are charges such as interest on overdue balance, over limit fees, service

taxes etc. All these charges were not a part of any banks earnings a few years earlier. Besides every time a credit or debit card is used, banks that have issued such cards are paid fees by the merchant. The introduction of credit cards has created this new addition to the bottom line of the bank's income statement.

**Commissions**

Banks have also started providing other services like selling insurance and mutual funds to their customers. Since banks have an intimate relationship with the customer, they are in a position to estimate their net worth and advise them regarding insurance as well as investment needs accordingly. Hence, insurance companies and mutual fund companies collaborate with banks to provide a one stop shop to the customers. Banks charge commissions to market these services to their customers. Over a period of time, commissions from bancassurance have started accounting for significant percentages of non interest incomes.

**Capital Market Advisory**

Banks often assist corporations in their debt issues in the bond market. They understand the macro-economic conditions very well given their vast experience with capital markets. Hence, they can advise corporations regarding the quantum of debt to be issued, the interest rate at which it needs to be issued as well as the time when issuing such debt would make selling it easier.

Banks usually do not underwrite these debt issues. Instead, they simply charge a flat fee for the advise that they provide and the expertise that they bring to the table.

**Demand Drafts and Pay Orders**

Demand drafts are different from negotiable instruments like cheques. When a bank issues a demand draft, it is no longer the customer's credibility which is at stake. Unlike cheques, demand drafts are issued by banks and therefore are paid and settled by banks on their own account. The bank is therefore providing a kind of guarantee to the party accepting the demand draft. For all practical purposes, a demand draft can be considered to be as good as cash because it is not subject to realization from the customer's account. A demand draft will always be paid unless the bank issuing it has gone bankrupt! Therefore banks charge a fee to provide a demand draft. This fees also forms a part of their non interest income.

**Guarantees**

Banks also provide the service of providing guarantees for a given fee. This service is used to bridge the trust gap between two parties. For instance, party A wants an advance payment whereas party B is willing to pay only after the work is completed. Neither party is willing to trust the other party. In such a case party B can deposit the funds with a bank and the bank can issue a guarantee to party A. Since the bank guarantee becomes a binding commitment made by a credible financial institution, party A can be rest assured that they will be paid once the work is completed as decided. The bank charges a fee for providing such a service. Bank guarantees are often used between first time trade partners. As trade is conducted often, counterparties become comfortable granting credit to each other and the need for bank guarantees is significantly reduced.

**Account Related Fees**

Banks also charge a wide variety of fees in order to maintain their customer's accounts. For instance when customers request checkbooks or additional debit cards, they are charged a fee. Besides, banks also charge penalties if the deposits maintained fall below a certain limit. They also charge fees if there are more than a certain number of withdrawals made within a given time period. Some form of payments made via bank accounts also result in fees being charged to the account.

**Lockers**

Lastly, banks also provide locker services to their customers. This was what the business of banking was originally about and most banks offer this service till date. Customers can store their valuables in the safe vaults of the bank and benefit from the extensive security that the bank has arranged for.

The bank cannot access the valuables stored in these vaults and in most cases does not have any information regarding the content of the vaults.

**Non-Fund Based/Fee Based Financial Services**

**1. Merchant banking:** Merchant banking is basically a service banking, concerned with providing non-fund based services of arranging funds rather than providing them. The merchant banker merely acts as an intermediary. Its main job is to transfer capital from those who own it to those who need it. Today, merchant banker acts as an institution which understands the requirements of the promoters on the one hand and financial institutions, banks, stock exchange and money markets on the other. SEBI (Merchant Bankers) Rule, 1992 has defined a merchant banker as, "any person who is engaged in the business of issue management either by making arrangements regarding selling, buying or subscribing to securities or acting as manager, consultant, advisor, or rendering corporate advisory services in relation to such issue management".

**2. Credit rating:** Credit rating means giving an expert opinion by a rating agency on the relative willingness and ability of the issuer of a debt instrument to meet the financial obligations in time and in full. It measures the relative risk of an issuer's ability and willingness to repay both interest and principal over the period of the rated instrument. It is a judgement about a firm's financial and business prospects. In short, credit rating means assessing the creditworthiness of a company by an independent organisation.

**3. Stock broking:** Now stock broking has emerged as a professional advisory service. Stock broker is a member of a recognized stock exchange. He buys, sells, or deals in shares/securities. It is compulsory for each stock broker to get himself/herself registered with SEBI in order to act as a broker. As a member of a stock exchange, he will have to abide by its rules, regulations and bylaws.

**4. Custodial services**: In simple words, the services provided by a custodian are known as custodial services (custodian services). Custodian is an institution or a person who is handed over securities by the security owners for safe custody. Custodian is a caretaker of a public property or securities. Custodians are intermediaries between companies and clients (i.e. security holders) and institutions (financial institutions and mutual funds). There is an arrangement and agreement between custodian and real owners of securities or properties to act as custodians of those who hand over it. The duty of a custodian is to keep the securities or documents under safe custody. The work of custodian is very risky and costly in nature. For rendering these services, he gets a remuneration called custodial charges. Thus custodial service is the service of keeping the securities safe for and on behalf of somebody else for a remuneration called custodial charges.

**5. Loan syndication:** Loan syndication is an arrangement where a group of banks participate to provide funds for a single loan. In a loan syndication, a group of banks comprising 10 to 30 banks participate to provide funds wherein one of the banks is the lead manager. This lead bank is decided by the corporate enterprises, depending on confidence in the lead manager. A single bank cannot give a huge loan. Hence a number of banks join together and form a syndicate. This is known as loan syndication. Thus, loan syndication is very similar to consortium financing.

**6. Securitisation (of debt):** Loans given to customers are assets for the bank. They are called loan assets. Unlike investment assets, loan assets are not tradable and transferable. Thus loan assets are not liquid. The problem is how to make the loan of a bank liquid. This problem can be solved by transforming the loans into marketable securities. Now loans become liquid. They get the characteristic of marketability. This is done through the process of securitization. Securitisation is a financial innovation. It is conversion of existing or future cash flows into marketable securities that can be sold to investors.

**Some of the important challenges are listed below:**

- Lack of qualified personnel in the financial service sector.
- Lack of investor awareness about the various financial services.

- Lack of transparency in the disclosure requirements and accounting practices relating to financial services.
- Lack of specialisation in different financial services (specialisation only in one or two services).
- Lack of adequate data to take financial service related decisions.
- Lack of efficient risk management system in the financial service sector. The above challenges are likely to increase in number with the growing requirements of the customers. However, the financial system in India at present is in a process of rapid transformation, particularly after the introduction of new economic reforms.

**2. Discuss the provisions of Insurance Act, 1938.**

**Insurance Regulatory Framework:**

1. Insurance Regulatory and Development Authority of India (IRDAI), is a statutory body formed under an Act of Parliament, i.e., Insurance Regulatory and Development Authority Act, 1999 (IRDAI Act 1999) for overall supervision and development of the Insurance sector in India.

2. The powers and functions of the Authority are laid down in the IRDAI Act, 1999 and Insurance Act, 1938. The key objectives of the IRDAI include promotion of competition so as to enhance customer satisfaction through increased consumer choice and fair premiums, while ensuring the financial security of the Insurance market.

3. The Insurance Act, 1938 is the principal Act governing the Insurance sector in India. It provides the powers to IRDAI to frame regulations which lay down the regulatory framework for supervision of the entities operating in the sector. Further, there are certain other Acts which govern specific lines of Insurance business and functions such as Marine Insurance Act, 1963 and Public Liability Insurance Act, 1991.

**4. IRDAI adopted a Mission for itself which is as follows:**

- To protect the interest of and secure fair treatment to policyholders;
- To bring about speedy and orderly growth of the Insurance industry (including annuity and superannuation payments), for the benefit of the common man, and to provide long term funds for accelerating growth of the economy;
- To set, promote, monitor and enforce high standards of integrity, financial soundness, fair dealing and competence of those it regulates;
- To ensure speedy settlement of genuine claims, to prevent Insurance frauds and other malpractices and put in place effective grievance redressal machinery;
- To promote fairness, transparency and orderly conduct in financial markets dealing with Insurance and build a reliable management information system to enforce high standards of financial soundness amongst market players;
- To take action where such standards are inadequate or ineffectively enforced;

To bring about optimum amount of self-regulation in day-to-day working of the industry consistent with the requirements of prudential regulation.

5. Entities regulated by IRDAI:

**a. Life Insurance Companies** - Both public and private sector Companies

**b. General Insurance Companies** - Both public and private sector Companies. Among them, there are some standalone Health Insurance Companies which offer health Insurance policies.

**c. Re-Insurance Companies**

**d. Agency Channel**

**e. Intermediaries** which include the following:

- Corporate Agents

- Brokers
- Third Party Administrators
- Surveyors and Loss Assessors.

**6. Regulation making process:**

- Section 26 (1) of IRDAI Act, 1999 and 114A of Insurance Act, 1938 vests power in the Authority to frame regulations, by notification.
- Section 25 of IRDAI Act, 1999 lays down for establishment of Insurance Advisory Committee consisting of not more than twenty five members excluding the ex-officio members. The Chairperson and the members of the Authority shall be the ex-officio members of the Insurance Advisory Committee.
- The objects of the Insurance Advisory Committee shall be to advise the Authority on matters relating to making of regulations under Section 26.
- Accordingly the draft regulations are first placed in the meeting of Insurance Advisory Committee and after obtaining the comments/recommendations of IAC, the draft regulations are placed before the Authority for its approval.
- Every Regulation approved by the Authority is notified in the Gazette of India.
- Every Regulation so made is submitted to the Ministry for placing the same before the Parliament.
- **The Authority has issued regulations and circulars on various aspects of operations of the Insurance companies and other entities covering:**
- Protection of policyholders' interest
- Procedures for registration of insurers or licensing of intermediaries, agents, surveyors and Third Party Administrators;
- Fit and proper assessment of the promoters and the management
- Clearance /filing of products before being introduced in the market
- Preparation of accounts and submission of accounts returns to the Authority.
- Actuarial valuation of the liabilities of life Insurance business and forms for filing of the actuarial report;
- Provisioning for liabilities in case of non-life Insurance companies
- Manner of investment of funds and periodic reports on investments
- Maintenance of solvency
- Market conduct issues

**C. Supervisory Role:**

1. The objective of supervision as stated in the preamble to the IRDAI Act is "to protect the interests of holders of Insurance policies, to regulate, promote and ensure orderly growth of the Insurance industry", both Insurance and Reinsurance business. The powers and functions of the Authority are laid down in the IRDAI Act, 1999 and Insurance Act, 1938 to enable the Authority to achieve its objectives.

2. Section 25 of IRDAI Act 1999 provides for establishment of Insurance Advisory Committee which has Representatives from commerce, industry, transport, agriculture, consume for a, surveyors agents, intermediaries, organizations engaged in safety and loss prevention, research bodies and employees' association in the Insurance sector are represented. All the rules, regulations, guidelines that are applicable to the industry are hosted on the website of the supervisor and are available in the public domain.

- **Section 14 of the IRDAI Act,1999 specifies the Duties, Powers and functions of the Authority. These include the following:**

To grant licenses to (re) Insurance companies and Insurance intermediaries

To protect interests of policyholders,

To regulate investment of funds by Insurance companies, professional organisations connected with the (re)Insurance business; maintenance of margin of solvency;

To call for information from, undertaking inspection of, conducting enquiries and investigations of the entities connected with the Insurance business;

To specify requisite qualifications, code of conduct and practical training for intermediary or Insurance intermediaries, agents and surveyors and loss assessors

To prescribe form and manner in which books of account shall be maintained and statement of accounts shall be rendered by insurers and other Insurance intermediaries;

D. Prudential approach: Reporting, Risk monitoring and intervention:

**1. Reporting Requirements:**

Insurers are required to submit various returns like financial statements on an annual basis duly accompanied by the Auditors' opinion statement on the annual accounts; reports of valuation of assets, valuation of liabilities and solvency margin; actuarial report and abstract and annual valuation returns giving information about the financial condition for life Insurance business; Incurred But Not Reported claims in case of general Insurance business; Reinsurance plans on an annual basis; and monthly statement on underwriting of large risks in case of general Insurance companies; details of capital market exposure on a monthly basis; Investment policy, Quarterly and annual returns on investments.

**2. Solvency of Insurers:**

In order to monitor and control solvency requirements, it has been made mandatory to the insurers to submit solvency report on quarterly basis. In case of any deviation, the Supervisor initiates necessary and suitable steps so as to ensure that the Insurer takes immediate corrective action to restore the solvency position at the minimum statutory level.

Computation of solvency margin takes into account the inherent risk that respective line of business poses to the insurer. Higher requirements are placed for risky lines of business compared to others posing less risk to the insurers.

**3. Asset-Liability Management:**

Under Asset-Liability Management reporting, Insurer must provide the year wise projected cash flows, in respect of both assets and liabilities. Insurers must maintain mismatching reserves in case of any mismatch between assets and liabilities as a part of the global reserves. Further, Life insurers are required to submit a report on sensitivity and scenario testing exercise in the prescribed format. Non-life insurers must submit a report on 'Financial Condition' covering the sensitivity analysis of the financial soundness in meeting the policyholders' liabilities.

**4. Reinsurance:**

Transfer of risk through Reinsurance is recognized only to the extent specified in the regulations. Due safeguards are built in to ensure that adjustments are made to provide for quality of assets held. No other risk transfer mechanism exists in the current system. In order to minimize the counterparty risk, the re-insurers with whom business is placed must have the minimum prescribed rating by an independent credit rating agency as specified in the regulations.

**5. Corporate Governance:**

In order to protect long- terms interests of policyholders, the IRDAI has outlined appropriate governance practices applicable to Insurance companies for maintenance of solvency, sound long-term investment policy and assumption of underwriting risks on a prudential basis from time to time. The IRDAI has issued comprehensive guidelines for adoption by Insurance companies on the governance responsibilities of the Board in the management of the Insurance functions. These guidelines are in addition to provisions of the Companies Act, 1956, Insurance Act, 1938 and other applicable laws.

**On and off site Supervision:**

**Onsite Inspections:**

The Authority has the power to call for any information from entities related to insurance business – Insurance companies and the intermediaries, as may be required from time to time.

On site inspection is normally carried out on an annual basis which includes inspection of corporate offices and branch offices of the companies. These inspections are conducted with view to check compliance with the provisions of Insurance Act, Rules and regulations framed thereunder.

The inspection may be comprehensive to cover all areas, or may be targeted on one, or a combination of, key areas. When a market-wide event having an impact on the insurers occurs, the Supervisor obtains relevant information from the insurers, monitors developments and issues directions as it may consider necessary.

**Off-site Inspection:**

The primary objective of off-site surveillance is to monitor the financial health of Insurance companies, identifying companies which show financial deterioration and would be a source for supervisory concerns. This acts as a trigger for timely remedial action.

The off-site inspection conducted by analyzing periodic statements, returns, reports, policies and compliance certificates mandated under the directions issued by the Authority from time to time. The periodicity of these filings is generally annual, half-yearly, quarterly and monthly and are related to business performance, investment of funds, remuneration details, expenses of management, business statistics, auditor certificates related to various compliance requirements.

3. **What are the methods and financing pattern under venture capital financing?**

**Methods of Venture Capital Financing**

These methods may vary in terminology or features from one geography to another; however, similar financing frameworks are available globally and cover mostly all formats of financing.

**Stages of Venture Capital Financing**

Following smart art shows the various stages of VC financing broadly based on Schilit's classification; however, some of the terminologies are adapted based on the evolution of the same and terms of common usage in the present time:

#1 – Seed Stage

At this stage, the funding is required for conducting market research for understanding the product feasibility or for developing the product based on prior market research and prototype developed.

#2 – Early Stage

At this stage, commercial selling has not been initiated, which is why funding is required. This stage has two subparts:

**Start-up:** The production has not started; funding is required for starting operations and doing initial marketing.

**First-Stage:** Financing is done to begin commercial selling.

#3 – Formative Stage

This is a broader term that engulfs both of the prior two or one of these stages. A very thin line demarcation between all such stages makes determining exactly when one ended and the other began very difficult. Therefore in such products, instead of having several stages, one bigger round of funding is done to encompass all.

#4 – Later Stage

This is after commercial selling has begun and one of the most common stages where the most money is invested. The venture capitalists have higher faith in the product because they can concretely visualize the same. This involves the following sub-stages:

**Second Stage** – The **profitability** has not yet occurred; the commercial sales have begun. However, the company requires initial scaling up because it wants to use the **economies of scale** and enter the profitability zone.

**Third Stage** – Here, the financing is for long-term expansion, such as creating a new plant that caters to a new geographical region; therefore, this involves a huge marketing expense.

**Mezzanine Financing** – This is similar to the straw before the last straw, i.e., the interim financing required by the company before its IPO is rolled out, and therefore, the name is given to it.

Advantages

**High Return** – If the venture is successful, there is a chance of a 40 to 50% return, which is higher than most investments. However, this return is not without risks, so it is a trade-off, and only those who have this level of **risk tolerance** should invest in the same.

**Participation in Innovation** – As the times when technology evolves, newer products keep entering the market, and older ones become obsolete; therefore, to keep the returns coming, a venture capitalist should keep investing in the innovations so that he develops a perennial return source.

**Launch-Pad for Entrepreneurship** – Small business gets the necessary resources for expansion and higher sales. Therefore VC investment drives entrepreneurship.

Disadvantages

**Lack of Liquidity** – As the shares in the company are not traded on the **stock exchange**, the investment becomes illiquid, and it is a big problem to find an interested buyer because the range of investor search becomes very limited. IPO or buyouts are more probable for successful ventures; however, if the venture is struggling or about to fail, exit becomes problematic.

**Long Term Investment** – As the investment can take place at a very early stage, and the returns may come at a very later date, therefore the gestation period till the time the company becomes attractive is quite longer than an average **investment horizon**. Only patient investors can take such an investment, however, the returns compensate for a greater period of **illiquidity**.

**Market Value Determination is very Difficult** –If the product is highly innovative, there might be very low chances of competitors. Also, there is a lower chance of gauging how the target audience will receive the product. Investment is made before such clarity can be gained; therefore, assessing the company's value is difficult because, at times, very promising ideas fail. So determining the amount of investment becomes a little more difficult.

**Limited Information** – As the companies have not existed for a long time, there is very little information regarding their financial position; further, as the product itself is new, the profitability numbers are also not present for too long a time, therefore finding a track record of the company and the product is very difficult.

**Lack of Information on Competition** – These companies work in silos. There is very little publicly available information about the company until it has reached the second or third stage of funding, when the product is commercially selling. Marketing is done at a larger scale. So it is very difficult to know how many companies are working on similar ideas, and therefore determining a reasonable market share is also difficult. All these add to the cloudiness of investment.

**4. Explain the working and advantages of factoring.**

**Factoring** is a financial technique where a specialized firm (factor) purchases from the clients accounts receivables that result from the sales of goods or services to customers. In this way, the customer of the client firm becomes the debtor of the factor and has to fulfil its obligations towards the factor directly.

The factoring agreement usually assumes that the whole credit risks as well as the collection of the accounts are taken by the factor. Factoring offers enterprises, particularly small and medium ones, a

means of financing their need for working capital, but also an instrument of collection of receivables and default risk hedging.

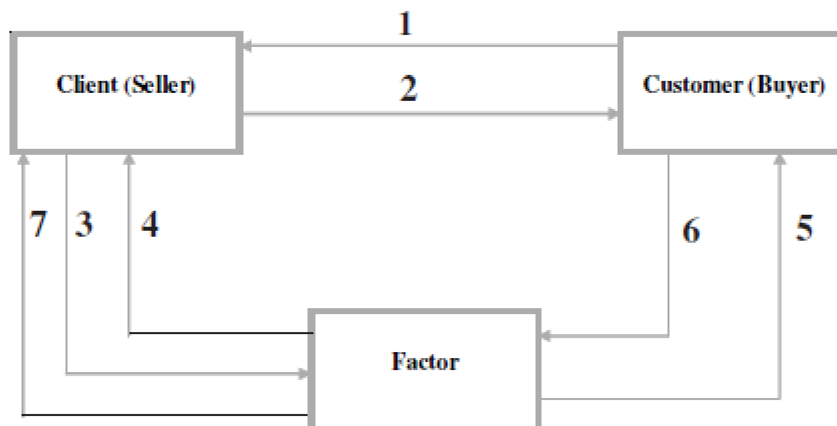
## Characteristics of Factoring

- Factor provides finance for the supplier, including loans and advance payments.
- Usually the period for factoring is 90 to 150 days. Some factoring companies allow even more than 150 days.
- Factoring is considered to be a less costly source of finance compared to other sources of short term borrowings.
- Factoring receivables is an ideal financial solution for new and emerging firms without strong financials. This is because creditworthiness is evaluated based on the financial strength of the customer (debtor). Hence these companies can leverage on the financial strength of their customers.
- Credit rating is not mandatory for factoring. But the factoring companies usually carry out credit risk analysis before entering into the agreement.
- Factoring is a method of off balance sheet financing.

## Mechanism of Factoring

In a factoring arrangement, there are three parties directly involved namely; the one who sells the invoice (client), the debtor (customer of the seller), and the factor (financial organization).
Seller of the product or service provider who originates the invoice is called Client and generally is a business firm.

Factor is thus an intermediary between the seller and buyer. Mechanics of Factoring shown in figure is explained below:




- Mechanism of Factoring
- Steps in Factoring Service
- Firstly, the customer places an order with the Client
- Client sends goods and invoice to customer
- Client assigns invoice to factor
- Factor make pre-payment up to 80 % to client
- Factor send statement to customer
- Customer make payment to factor
- Factor makes balance 20% on realisation to client.

## Advantages of Factoring

Following are some of the advantages of factoring services:

**Substitute for market credit**: Factoring has an important role in working capital finance. Factoring substitutes bank borrowings and supplements the market credit or suppliers' credit. It replaces high-cost bank loans.

**Time Savings**: Factoring can save time and effort to the company that would otherwise be spent on collecting from customers. That energy can be redirected to other business-building activities, like sales, marketing and client development.

**No Collateral Required**: Unlike traditional bank loans, factoring doesn't require you to risk your home or other property as collateral.

**Reduction in operating cycle time**: With factoring, the average receivables collection period is reduced substantially and as a consequence the total operating cycle time of the client is reduced. This contributes to efficient working capital.

**Liquidity**: Factoring helps the company to raise cash, even up to 90% of the invoice value immediately after the sale. This builds the liquidity position of the client.

**Advisory Services**: Factoring institutions offer a variety of advisory services to its clients including credit assessment for its overseas buyers.

## Disadvantages of Factoring

Factoring provides a pool of benefits to a business by providing immediate cash for your account receivables. However, it also has some drawbacks that need to be considered before deciding on factoring services. Some of these drawbacks are as follows:

**Adverse relationship with customers**: Factoring companies are usually more aggressive while collecting debts, and this may upset the customer and lead to nil or decreased sales by the customers.

**Potential change in business practices**: A Factor may insist on changing business strategies, and interfere in the working of the business and may even recommend cutting off certain customers. This highlights the necessity of ensuring that the businessman chooses to work with such a lender who understands his business and is interested in its growth.

## Types of Factoring

There are a number of types of factoring in both theory and practice. Various types of factoring depend on the relation between the main parties in the factoring operation.

It also depends on the specific features in the factoring agreement. The most common feature of practically all the factoring transactions is collection of receivables and administration of sale ledger. However, following are some of the important types of factoring arrangements

### Recourse and Non-recourse Factoring

In recourse factoring, the factor does not assume the credit risk (risk of non-payment by the debtors). In other words, if the receivables become bad, i.e. if the customer does not pay on maturity, risk of bad receivables remains with the seller, and the factor does not assume any risk associated with the receivables.

The factor provides the service of receivables collection, but does not cover the risk of the buyer failing to pay the debt. The factor can recover the funds from the seller (client) in the case of such default. The seller assumes the risks associated with the credit and the buyer's creditworthiness.

### Domestic and Export Factoring

In domestic factoring three parties are involved (the seller, the buyer, and the factor), while in export factoring there are four (the seller, the buyer, the domestic factor, and the factor abroad). In domestic factoring, the factor mediates between the seller and the buyer.

### Conventional or Full Factoring

The factor also fixes up a draw limit based on the bills outstanding maturity-wise and takes the corresponding risk of default or credit risk and the factor will have claims on the debtor as also the client creditor.

Full factoring is also known as Old Line Factoring. In India, factoring agencies like SBI Factors are doing full factoring for good companies with recourse.

**5. Discuss the role of SEBI under merchant banking.**

A merchant banker underwrites corporate securities and provides guidelines to clients on issues like corporate mergers. The merchant banker may be in the form of a bank, a firm, company or even a proprietary concern. It is basically service banking which provides non-financial services such as arranging for funds rather than providing them.

The merchant banker understands the requirements of the business concerns and arranges finance with the help of financial institutions, banks, stock exchanges, and money market.

**Regulations by SEBI on Merchant Banking**

**Reforms for the merchant bankers**

SEBI has made the following reforms for the merchant banker

1. Multiple categories of merchant banker will be abolished and there will be only one equity merchant banker.
2. The merchant banker is allowed to perform underwriting activity. For performing portfolio manager, the merchant banker has to seek separate registration from SEBI.
3. A merchant banker cannot undertake the function of a non banking financial company, such as accepting deposits, financing others' business, etc.
4. A merchant banker has to confine himself only to capital market activities.

**Recognition by SEBI on merchant bankers**

SEBI will grant recognition a merchant banker after taking into account the following aspects

1. Considering how much the merchant are professionally competent.
2. Whether they have adequate capital
3. Track record, experience and general reputation of merchant bankers.
4. Quality of staff employed by merchant bankers, their adequacy and available infrastructure are taken into account. After considering the above aspects, SEBI will grant permission for the merchant banker to start functioning.

**Conditions by SEBI for merchant bankers**

SEBI has laid the following conditions on the merchant bankers, for conducting their operations. They are

1. SEBI will give authorization for a merchant banker to operate for 3 years only. Without SEBI's authorization, merchant bankers cannot operate.
2. The minimum net worth of merchant banker should be Rs. 1 crore.
3. Merchant banker has to pay authorization fee, annual fee and renewal fee.
4. All issue of shares must be managed by one authorized merchant banker. It should be the lead manager.
5. The responsibility of the lead manager will be clearly indicated by SEBI.
6. Lead managers are responsible for allotment of securities, refunds, etc.
7. Merchant banker will submit to SEBI all returns and send reports regarding the issue of shares.

8. A code of conduct for merchant bankers will be given by SEBI, which has to be followed by them.
9. Any violation by the merchant banker will lead to the revocation of authorization by SEBI.