BANKING AND FINANCIAL SERVICE

B.A (Economics)

THIRD YEAR, SEMESTER–V

Lesson Writers

Dr. P. Venu Gopal
Head of the Department
Department of Economics
Hindu College
Guntur.

Dr. Shaik Ameer
Academic Counselor in Economics
Centre for Distance Education
Acharya Nagarjuna University.

Dr. M. Syamala
Academic Counselor in Economics
Centre for Distance Education
Acharya Nagarjuna University.

Dr. P. Mercy Kumari
Academic Counselor in Economics
Centre for Distance Education
Acharya Nagarjuna University.

Editor

Dr. P. Venu Gopal
Head of the Department
Department of Economics
Hindu College
Guntur.

Director

Dr.NAGARAJU BATTU
MHRM., MBA.,LLM.,M.Sc.(Psy).,MA(Soc).,M.Ed.,M.Phil.,Ph.D,

CENTRE FOR DISTANCE EDUCATION
ACHARAYA NAGARJUNA UNIVERSITY
NAGARJUNANAGAR – 522510
Ph:0863-2346208,2346222,
0863-2346259(Study Material)
Website:www.anucde.info
e-mail:anucdedirector@gmail.com

B.A(Economics): Banking and Financial Services

First Edition : 2024

No. of Copies :

©Acharya Nagarjuna University

This book is exclusively prepared for the use of students of B.A (Economics) Centre for Distance Education, Acharya Nagarjuna University and this book is meant for limited Circulation only.

Published by:

Dr. NAGARAJU BATTU,

Director

Centre for Distance Education,

Acharya Nagarjuna University

Printed at:

FOREWORD

Since its establishment in 1976, Acharya Nagarjuna University has been forging a head in the path of progress and dynamism, offering a variety of courses and research contributions. I am extremely happy that by gaining 'A' grade from the NAAC in the year 2016, Acharya Nagarjuna University is offering educational opportunities at the UG, PG levels apart from research degrees to students from over 443 affiliated colleges spread over the two districts of Guntur and Prakasam.

The University has also started the Centre for Distance Education in 2003-04 with the aim of taking higher education to the door step of all the sectors of the society. The centre will be a great help to those who cannot join in colleges, those who cannot afford the exorbitant fees as regular students, and even to housewives desirous of pursuing higher studies. Acharya Nagarjuna University has started offering B.A., and B.Com courses at the Degree level and M.A., M.Com., M.Sc., M.B.A., and L.L.M., courses at the PG level from the academic year 2003-2004onwards.

To facilitate easier understanding by students studying through the distance mode, these self-instruction materials have been prepared by eminent and experienced teachers. The lessons have been drafted with great care and expertise in the stipulated time by these teachers. Constructive ideas and scholarly suggestions are welcome from students and teachers involved respectively. Such ideas will be incorporated for the greater efficacy of this distance mode of education. For clarification of doubts and feedback, weekly classes and contact classes will be arranged at the UG and PG levels respectively.

It is my aim that students getting higher education through the Centre for Distance Education should improve their qualification, have better employment opportunities and in turn be part of country's progress. It is my fond desire that in the years to come, the Centre for Distance Education will go from strength to strength in the form of new courses and by catering to larger number of people. My congratulations to all the Directors, Academic Coordinators, Editors and Lesson-writers of the Centre who have helped in these endeavors.

Prof. P. RajaSekhar
Vice-Chancellor
Acharya Nagarjuna University

A.P. State Council of Higher Education

Semester-Wise Revised Syllabus under CBCS, 2020-21

Course Code: 502ESE21

Four-Year B.A. (Hons)

Domain Subject: **ECONOMICS**

IV Year B.A.(Hons)-Semester-V

Max Marks: 100

Course 7C: **Banking and Financial Services**
(Skill Enhancement Course (Elective), 4 Credits)

I. Learning Outcomes:

Students at the successful completion of the course shall be able to:

1. Explain the concept and essentials banking and financial services.
2. Identify and analyse the employment opportunities related to banks and other financial institutions.
3. Apply the concepts to banking and financial opportunities and formulate ideas related to them.
4. Demonstrate practical skills to enable them to get employment in Banks and other financial institutions as business correspondents or Common Service Centers or marketing agents.

II. Syllabus: (Hours: Teaching: 60, Training: 10, Others Including Unit Tests: 05)

Unit1: Principles of Banking and Indian Banking System

Meaning of Banking – Principles of Banking – Functions of Banking – Structure of Indian Banking System – Regulations of Banking in India – Role of RBI in Banking – Anti-money Laundering - Basics of Financial literacy - Problems and Challenges of Banking in India.

Unit 2: Deposits, Loans and Digital Banking

Bank Deposit Account Types – Account Opening and Closing – Banking Customer types – KYC Norms – Negotiable Instruments: Cheque, Bill of Exchange, Promissory Note, Endorsement - Principles of Lending – Different categories of Loans – Mortgaging -Priority Sector Lending – E-Banking facilities: Debit Card, Credit Card, Net Banking, Mobile Banking, Tele-banking, Micro ATMs, Digital Currency – Core Banking Solutions.

Unit 3: Banking Correspondents and Common Service Centers

Banking Correspondent Model - Activities of Banking Correspondent: Deposit Mobilization. Identification of Borrowers, Collection and Recovery Loan, Other Banking Services – Common Services Centre (CSC) - Provision of Services by CSC – Requirement for Registering CSC and Telecentre - Case Study of Banking Correspondents with any Bank or CSC in Local Area.

Unit 4: Financial Services of NBFIs

Non-Banking Financial Institutions (NBFIs): Types and Major Players of NBFIs in India – Important Financial Services offered by NBFIs and their Features – Concept of EMI - Micro Finance: Concept and Operation - Chit Funds: Concept and Operations– Payment Banks - Regulations of NBFIs in India – Problems and Challenges of NBFIs in India.

Unit 5: Work with Finance Service Company (FSC)

Types of loans by Finance Service Company (FSC) – Customer of FSC: Types and Needs - Marketing of FSC's Loans – Procedures and Requirements in FSC's Loan Sanction - Collection and Recovery of FSC Loans - Case Study of a FSC's services in Local Area.

III. References:

1. Indian Institute of Banking and Finance: ***Principles and Practices of Banking,*** Macmillan India Limited, 2021. https://drive.google.com/file/d/1VU7aN4s5ikPQl7nX6mTBW-sVLQCNhfvK/view
2. Indian Institute of Banking and Finance: ***Retail Baking,*** Macmillan India Limited, 2015.
3. D.R.Patade Babasaheb Sangale and T.N.Salve : ***Banking and Finance:*** *Fundamental of Banking,* Success Publications, Pune, January *2013.* https://app1.unipune.ac.in/external/course-material/Fundamental-of-Banking-English.pdf
4. N. Mukund Sharma: ***Banking and Financial Services***, Himalaya Publishers, 2015.
5. Akhan Ali Jafor: ***Non-Banking Financial Companies in India: Functioning and Practice,*** New Century Publications, New Delhi, 2010.
6. RBI: "Non-Banking Financial Institutions" in ***Report on Trend and Progress of Banking in India 2019-20.***
7. RBI: Discussion Paper on ***Engaging Business Correspondents***. https://www.rbi.org.in/scripts/bs_viewcontent.aspx?Id=2234
8. Govt. of India: Ministry of Electronic and Information Technology: ***Digital Seva-Operational Manual for Common Service Centre***s. https://csc.gov.in/assets/cscmanual/digitalsevaoperationalmanual.pdf
9. http://www.cscentrepreneur.in/ for Telecentre Entrepreneurship Course
10. https://www.rbi.org.in/
11. http://www.iibf.org.in/

12. Other Relevant web resources suggested by the teacher and college librarian

IV. Co-Curricular Activities:

a) Mandatory (*Training of students in the related skills by the teacher for a total 10 Hours)*
1) **For Teacher**: Training of students by teacher in the classroom and in the field for a total of not less than10 hours on skills and hands on experience like opening and closing bank account, explaining negotiable instruments, loan application process at banks, operation of digital banking, operating common service center, loan application and sanction in FSC, make use of important websites and apps etc. pertaining to banks and FSCs and make a field visit to any bank and FSC in local area. The expertise of practicing insurance agent or trainer can be utilized for this purposes.

2) **For Student:** Students shall visit and understand the functioning of bank and FSC of their interest in the local area. They shall write their individual observations in the given format, not exceeding 10 pages, and submit to the teacher, as Fieldwork/Project work Report

3) **Suggested Fieldwork/Project work Format (***Report shall not exceed 10 pages*):
Title Page, Student Details, Acknowledgments, Index page, Objectives, Step-wise process, Findings, Conclusion & References.
4) Max Marks for Fieldwork/Project work Report: 05
5) Unit Tests/Internal Examinations.

b) Suggested Co-Curricular Activities

1. Invited Lectures with academic experts, practicing bankers, trainers and concerned officials.
2. Hands on experience by field experts.
3. Assignments
4. Debates on related topics
5. Seminars, Group discussions, Quiz, etc.

Note: For the latest topics which have no formal material available, the teacher is expected to prepare own material by using multiple latest sources and practical knowledge.

###

(502ESE21)

MODEL QUESTION PAPER

B. A. Degree Examination

Third Year -Semester- V

Part – II: Economics

7 -C - BANKING AND FINANCIAL SERVICES

Time : Three hours **Maximum Marks : 70**

Section – A

Answer any FIVE of the following questions.
Each answer carries 5 marks.

(5 x 4 = 20 Marks)

1. Meaning and definition of Bank.
బ్యాంకు యొక్క అర్థం మరియు నిర్వచనం రాయండి.

2. Financial market.
ఆర్థిక మార్కెట్

3. Distinguish between capital market and money market.
రాజధాని మార్కెట్ మరియు మనీ మార్కెట్ మధ్య తేడాను గుర్తించండి?

4. Write a short note on priority sector lending.
ప్రాధాన్యత రంగం రుణం పై చిన్న గమనిక రాయండి.

5.Primary market and secondary market.
ప్రైమరీ మార్కెట్ మరియు సెకండరీ మార్కెట్,

6.Meaning and structure of financial services.
ఆర్థిక సేవల అర్థం మరియు నిర్మాణం.

7.Definition and meaning of mutual funds.
మ్యూచువల్ ఫండ్స్ యొక్క నిర్వచనం మరియు అర్థం.

8.Write a short note on factoring.
ఫ్యాక్టరింగ్ పై చిన్న నోట్సు రాయండి.

SECTION - B

Write answer for the following five questions.
Each question carries 10 marks.

(5×10= 50 marks)

9. (a) Briefly explain the structure of financ system.
ఆర్థిక వ్యవస్థ నిర్మాణాన్ని క్లుప్తంగా వివరించండి.

Or

(b) What is the co-operative banking? Briefly explain its functions and drawbacks?
సహకార బ్యాంకింగ్ అంటే ఏమిటి? దాని విధులు మరియు లోపాలను క్లుప్తంగా వివరించండి?

10. (a) Explain the advantages of E-Banking
ఈ --బ్యాంకింగ్ ప్రయోజనాలను వివరించండి?

Or

(b) Explain the about qualitive and quantitive credit control measures of RBI
RBI యొక్క గుణాత్మక మరియు పరిమాణాత్మక క్రెడిట్ నియంత్రణ చర్యలు గురించి వివరించండి.

11. (a) What is SEBI? Explain its functions.
SEBI అంటే ఏమిటి? దాని విధులు ఏమిటి?

Or

(b) What is merchant banking? Briefly explain the functions of merchant banking.
మర్చంట్ బ్యాంకింగ్ అంటే ఏమిటి? మర్చంట్ బ్యాంకింగ్ యొక్క విధులను క్లుప్తంగా వివరించండి?

12. (a) Meaning, definition and functions of insurance.
భీమా యొక్క అర్థం నిర్వచనం మరియు విధులు?

Or

(b) Briefly explain the procedure for issue life insurance.
లైఫ్ ఇన్సురెన్స్ పాలసీని జారీ చేసే విధానాన్ని క్లుప్తంగా వివరించండి.

13. (a) Briefly explain the trending procedure for purchase and sale of securities.
సెక్యూరిటీల కొనుగోలు మరియు అమ్మకానికి సంబంధించిన ట్రెండింగ్ విధానాన్ని క్లుప్తంగా వివరించండి.

Or

(b) Briefly describe the functions of commercial banks.
వాణిజ్య బ్యాంకుల విధులను క్లుప్తంగా రాయండి.

CONTENTS

Unit	L.No.	Lesson name	Page No.
U - I	1.	Banking Principles	1.1 – 1.13
	2.	Regulations of Banking in India	2.1 – 2.10
	3.	Anti-Money Laundering (AML)	3.1 – 3.11
	4.	Financial Literacy	4.1 – 4.10
U - II	5.	Problems and challenges of Banking in India	5.1 – 5.10
	6.	Bank Deposits	6.1 – 6.07
	7.	Negotiable Instruments	7.1 – 7. 11
U - III	8.	Principles of Lending	8.1 – 8.14
	9.	e-Banking	9.1 – 9.13
	10.	Correspondent Banking Model	10.1 – 10.10
	11.	Common Service Centers	11.1 – 11.10
U - IV	12.	Role of Micro Finance and Chit funds in India	12.1 – 12.15
	13.	Role of payment Banks in India	13.1 – 13.9
	14.	Non-Banking financial Institutions in India	14.1 – 14.11
U - V	15.	Finance Service Company Loans and its customers	15.1 – 15.15
	16.	Marketing of finance Service Company Loans	16.1 – 16.10
	17.	Case Studies on banking and Other Financial Services	17.1 – 17.17

LESSON – 1
BANKING PRINCIPLES

Aims and Objectives:

After reading this lesson the student would know the following aims and objectives:

- To understand meaning of banking
- To understand principles of banking
- To know the functions of banking
- To understand structure of Indian banking system

Structure

1.1 Introduction
1.2 Meaning and definition of bank
1.3 Characteristics of bank
1.4 Importance of banks
1.5 Banking Principles
1.6 Functions of banking
1.7 Structure of Indian banking system
1.8 Summary
1.9 Key words
1.10 Self-Assessment Questions
1.11 Suggested Readings

1.1 INTRODUCTION

The transactions done with a bank and the services that is offered to the customers is collectively known as banking. Banking can be done either online or offline or in both ways. Banking services mainly include accepting deposits and lending loans apart from facilitating transactions, offering various financial products like savings account, credit cards etc. Banking refers to a system of financial institutions like banks and credit unions which provide various financial services to individuals, business and government. Banking plays a vital role in any economy as it helps the flow of money into the economy and enables economic activities. Banking is the business of protecting money for others. Bank lend this money and generate interest which creates profits to the banks and its customers. A bank is a financial institution licensed to help its customers with deposits and loans.

This chapter helps the students to understand the meaning of bank, characteristics of banks, functions of banks. Further the structure of banking system in India is also discussed.

1.1 MEANING AND DEFINITION OF BANK

A bank is an institution which deals with money and credit. It accepts deposits and advances loans to those who need them, and helps in the remittance of money from one place to another. Bank is a financial institution where the customers can save their money and also borrow. Banks also invest money in order to build their reserves of money. Banks are

regulated by laws, which differ from country to country. The banking system constitutes the core of the financial sector. It plays a very vital role in the process of economic growth of the country. Its efficiency and development are significant for the country's economic progress. Banks play an important role in the organised sector of the Indian money market. They are the major source of institutional finance in the country. Modern Banks perform a variety of functions hence it is not easy to define bank and banking system. Different economists have viewed the concept of bank and banking in different way.

According to Cairn Cross "Bank is a financial intermediary institution which deals in loans and advances.

Indian Company Law 1936 defines Bank as "a banking company which receives deposits through current account or any other forms and allows withdrawal through cheques or promissory notes.

In the words of Kinley, "A bank is an establishment which makes to individuals such advances of money as may be required and safely made, and to which individuals entrust money when not required by them for use".

In the views of P.A. Samuelson, "Bank provides service to its clients and in turn receives perquisites in different forms."

According to Crowther, a bank "collects money from those who have it to spare or who are saving it out of their incomes, and it lends this money to those who require it".

R.P. Kent viewed it as, "Bank is an institution which collects idle money temporarily from the public and lends to other people as per need.".

W. Hock defined bank as "Bank is such an institution which creates money by money only."

R.S.Sayers defines the term a bank as "an institution whose debts are widely accepted in settlement of other people's debts to eachother".

According to the Indian Banking Regulation Act, 1949, banking means "the accepting for the purpose of lending or investment, of deposits of money from the public, repayable on demand or otherwise, and withdraw able by cheque, draft or otherwise".

In short, the term bank refers to an institution which has the following features:

1 It deals with money; it accepts deposits and advances loans.
2 It is commercial institution; it aims at earning profit.
3 It also deals with credit; it has the ability to create credit i.e., the ability to expand its liabilities as a multiple of its reserves.
4 It is unique financial institution that creates demand deposits which serve as a medium of ex- change and as a result, the banks manage the payment system of the country.

1.2 CHARACTERISTICS OF BANK

The main characteristic features of a bank are as follows:

1. Bank is a financial institution which deals with money given by depositors.
2. A bank may be a person, firm or a company.
3. A bank accepts money from the people in the form of deposits.
4. It gives safety to the deposits of its customers.
5. It also acts as a custodian of funds of its customers.
6. A bank lends out money in the form of loans to the needy.
7. A bank provides easy payment and withdrawal facility to its customers in the form of cheques and drafts.
8. A bank provides various banking facilities to its customers.
9. A bank is a profit seeking institution having service-oriented approach.
10. Bank acts as a connecting link between the borrowers and lenders of money.

1.4 IMPORTANCE OF BANKS

Bankers play very important role in the economic development of the nation. The growth of the economy depends on the development of banking system in the country. Though the banks don't create any new wealth still their process of collecting deposits and advancing loans helps in the process of production, distribution, exchange and consumption of wealth.

Importance of banks are as follows:

1. Banks mobilize small, scattered and idle savings of the people.
2. Banks make deposits available for productive purposes.
3. Banks provide convenient and economical means of transfer of funds
4. Banks promote savings by offering attractive interest rates.
5. Banks safe guard the savings of public.
6. Banks facilitate the movement of funds from unused regions to useful regions
7. Banks provide convenient and economical means of payments.
8. Banking connects saving and investment process
9. Banking help trade, commerce, industry and agriculture by meeting their financial requirements
10. Through their control over the supply of money, Banks influence the economic activities, employment, income level and price level in the economy.

1.5 BANKING PRINCIPLES

The financial world relies on banking principles to maintain stability and functionality. Foundation of banking system lies in the unwavering commitment to safety and reliability. Banks stand responsible for safe guarding their customer's funds and investments. The main banking principles are:

1. **Maintaining liquidity** – maintaining liquidity is the vital principle of any bank as it ensures a bank can meet its short-term responsibilities. Bank must manage the balance between assets and liabilities to ensure they can handle the withdrawal requests and other financial commitments. Only if the bank can maintain this balance strategy liquidity crises can be prevented. It will also contribute to the overall strength of the financial system.

2. **Balancing profitability -** Banks are not only responsible for handling the money of the customers but also aim to gain profits. In fact, profitability is the fundamental principle that makes the banks to sustain their operations and expand their services. Banks need to make a balance between making profits and offering valuable services to their customers for successful functioning.

3. **Practicing prudence –** The principle of prudence emphasizes careful decision making in banking operations. Banks should assess risks, lending decisions and keep enough reserves to absorb potential losses. Practicing prudence is a protective measure against risky financial practices, contributing to long run success of banks.

4. **Upholding customer confidentiality-** The bank should upload the customer's trust and confidence. Trust is the key foundation of banking and customer confidentiality is the fundamental concept in building the trust of the customer. Banks are obliged to keep their customer's financial information secure and confidential. The commitment of privacy builds confidence among the customers. It creates a strong and long-lasting relationship between the banks and the customers.

5. **Embracing diversification -** The principle of diversification is followed by the banks to minimize the risk and adapt to changings in economic conditions. In this process banks spread investments across different sectors and industries. By diversifying their portfolios banks reduce the impact of economic down turns of their overall financial position.

6. **Transparency -** Transparency is one of the crucial principles of banking which strengthens trust between the banks and their customers. Banks must provide clear and comprehensive information about their operations, financial conditions and risk exposures. Transparent practices will enhance accountability and allow the customers to relay on the banks with confidence.

7. **Fostering innovation –** In this fast-moving economy it is necessary for the banks to be more innovative to meet the competitive world. Innovation helps the banks to stay competitive and resilient in a dynamic market and ultimately helps to contribute to the overall growth and advancement of the industry.

8. **Promoting financial inclusion-** Banks are the crucial financial promotors. They provide access to banking services to diverse individuals and businesses. This involves creating products and services that meet underserved needs of the people and helps in economic growth and inclusivity.

9. **Maintaining ethical standards –** Maintaining ethical standards is one of the fundamental concepts in banking. Banks must conduct their operations with integrity,

honesty and fairness. They must stick to ethical standards and help to build trust among the customers.

10. **Solvency -** Solvency means the financial capability. The banks should stay in this competitive market with sufficient capital.

Apart from the above principles banks should also have principle of goodwill, economy, service, investment lending loans, publicity and efficiency. Banking professionals and the public must understand the main principles of banking. These principles are the foundation that supports integrity, stability and good functioning of the banking sector in the economy. By understanding these principles one can enter into banking sector with clarity regarding the functions and principles of banking.

1.6 FUNCTIONS OF BANKING

Banks in India offer a wide range of banking services, such as savings and checking accounts, loans, credit cards, investment services, and electronic banking options like online and mobile banking. Some of the major functions of banks are:

- **Accepting Deposits:** Banks provide a safe place for individuals and businesses to deposit their money, which can be withdrawn when needed. This is the primary function of any bank.

Bank accepts different types of deposits from the public such as:

1. **Saving Deposits:** encourages saving habits among the public. It is suitable for salary and wage earners. The rate of interest is low. There is no restriction on the number and amount of withdrawals. The account for saving deposits can be opened in a single name or in joint names. The depositors just need to maintain minimum balance which varies across different banks. Also, Bank provides ATM cum debit card, cheque book, and Internet banking facility. Candidates can know about the Types of Cheques at the linked page.
2. **Fixed Deposits:** Also known as Term Deposits. Money is deposited for a fixed tenure. No withdrawal money during this period allowed. In case depositors withdraw before maturity, banks levy a penalty for premature withdrawal. As a lump-sum amount is paid at one time for a specific period, the rate of interest is high but varies with the period of deposit.
3. **Current Deposits**: They are opened by businessmen. The account holders get an overdraft facility on this account. These deposits act as a short-term loan to meet urgent needs. Bank charges a high-interest rate along with the charges for overdraft facility in order to maintain a reserve for unknown demands for the overdraft.
4. **Recurring Deposits:** A certain sum of money is deposited in the bank at a regular interval. Money can be withdrawn only after the expiry of a certain period. A higher rate of interest is paid on recurring deposits as it provides a benefit of compounded rate of interest and enables depositors to collect a big sum of money. This type of account is operated by salaried persons and petty traders.

- **Providing Loans**: this is another primary function of any bank. Banks lend money to individuals and businesses for various purposes, such as home mortgages, business expansion, or personal loans.

Bank offers the following types of Loans and Advances:

1. **Bank Overdraft**: This facility is for current account holders. It allows holders to withdraw money anytime more than available in bank balance but up to the provided limit. An overdraft facility is granted against collateral security. The interest for overdraft is paid only on the borrowed amount for the period for which the loan is taken.
2. **Cash Credits:** A short-term loan facility up to a specific limit fixed in advance. Banks allow the customer to take a loan against a mortgage of certain property. Cash credit is given to any type of account holders and also to those who do not have an account with a bank. Interest is charged on the amount withdrawn in excess of the limit. Through cash credit, a larger amount of loan is sanctioned than that of overdraft for a longer period.
3. **Loans:** Banks lend money to the customer for short term or medium periods of 1 to 5 years against tangible assets**.** Nowadays, banks do lend money for the long term also. The borrower repays the money either in a lump-sum or in the form of instalments over a pre-decided time period. Bank charges interest on the actual amount of loan sanctioned, whether withdrawn or not. The interest rate is lower than overdrafts and cash credits facilities.
4. **Discounting the Bill of Exchange:** It is a type of short-term loan, where the seller discounts the bill from the bank for some fees. The bank advances money by discounting or purchasing the bills of exchange. It pays the bill amount to the drawer(seller) on behalf of the drawee (buyer) by deducting usual discount charges. On maturity, the bank presents the bill to the drawee or acceptor to collect the bill amount.

- **Payments and Settlements:** Banks enable transactions through various payment methods, like checks, debit/credit cards, and electronic transfers.
- **Currency Exchange**: Many banks offer foreign exchange services, allowing customers to buy, sell, or exchange foreign currencies.
- **Safekeeping of Valuables:** Some banks offer safe deposit boxes for customers to securely store valuable items and documents.
- **Investment Services**: Banks also provide investment products like mutual funds, stocks, and bonds, helping customers grow their wealth.
- **Internet Banking Services:** Banks offer online and mobile banking services, making it convenient for customers to access their accounts, pay bills, and transfer funds.

The following are some of the secondary functions that banks perform:

- **Transfer of Funds**: Transferring of funds from one branch/place to another.
- **Periodic Collections**: Collecting dividend, salary, pension, and similar periodic collections on the clients' behalf.
- **Periodic Payments**: Making periodic payments of rents, electricity bills, etc on behalf of the client.
- **Collection of Cheques**: Like collecting money from the bills of exchanges, the bank collects the money of the cheques through the clearing section of its customers.
- **Portfolio Management**: Banks manage the portfolio of their clients. It undertakes the activity to purchase and sell the shares and debentures of the clients and debits or credits the account.

- **Other Agency Functions**: Under this bank act as a representative of its clients for other institutions. It acts as an executor, trustee, administrators, advisers, etc. of the client.
- **Utility Functions of Bank**
  - Issuing letters of credit, traveler's cheque, etc.
  - Undertaking safe custody of valuables, important documents, and securities by providing safe deposit vaults or lockers.
  - Providing customers with facilities of foreign exchange dealings
  - Underwriting of shares and debentures
  - Dealing in foreign exchanges
  - Social Welfare programs
  - Project reports

Basing on the type of bank the functions vary

1. **Central Bank -** The Reserve Bank of India is the central bank of our country. Each country has a central bank that regulates all the other banks in that particular country.

The main function of the central bank is to act as the Government's Bank and guide and regulate the other banking institutions in the country. Given below are the functions of the central bank of a country:

- Guiding other banks
- Issuing currency
- Implementing the monetary policies
- Supervisor of the financial system

In other words, the central bank of the country may also be known as the banker's bank as it provides assistance to the other banks of the country and manages the financial system of the country, under the supervision of the Government.

2. **Cooperative Banks**

These banks are organised under the state government's act. They give short term loans to the agriculture sector and other allied activities. The main goal of Cooperative Banks is to promote social welfare by providing concessional loans

They are organised in the 3-tier structure:

- Tier 1 (State Level) – State Cooperative Banks (regulated by RBI, State Govt, NABARD)
  - Funded by RBI, government, NABARD. Money is then distributed to the public
  - Concessional CRR, SLR applies to these banks. (CRR- 3%, SLR- 25%)
  - Owned by the state government and top management is elected by members
- Tier 2 (District Level) – Central/District Cooperative Banks
- Tier 3 (Village Level) – Primary Agriculture Cooperative Banks

3. **Commercial Banks**
   - Organised under the Banking Companies Act, 1956

- They operate on a commercial basis and its main objective is profit.
- They have a unified structure and are owned by the government, state, or any private entity.
- They tend to all sectors ranging from rural to urban
- These banks do not charge concessional interest rates unless instructed by the RBI
- Public deposits are the main source of funds for these banks

The commercial banks can be further divided into three categories:

1. **Public sector Banks** – A bank where the majority stakes are owned by the Government or the central bank of the country.
2. **Private sector Banks** – A bank where the majority stakes are owned by a private organization or an individual or a group of people
3. **Foreign Banks** – The banks with their headquarters in foreign countries and branches in our country, fall under this type of bank

1.7 STRUCTURE OF BANKING SYSTEM IN INDIA

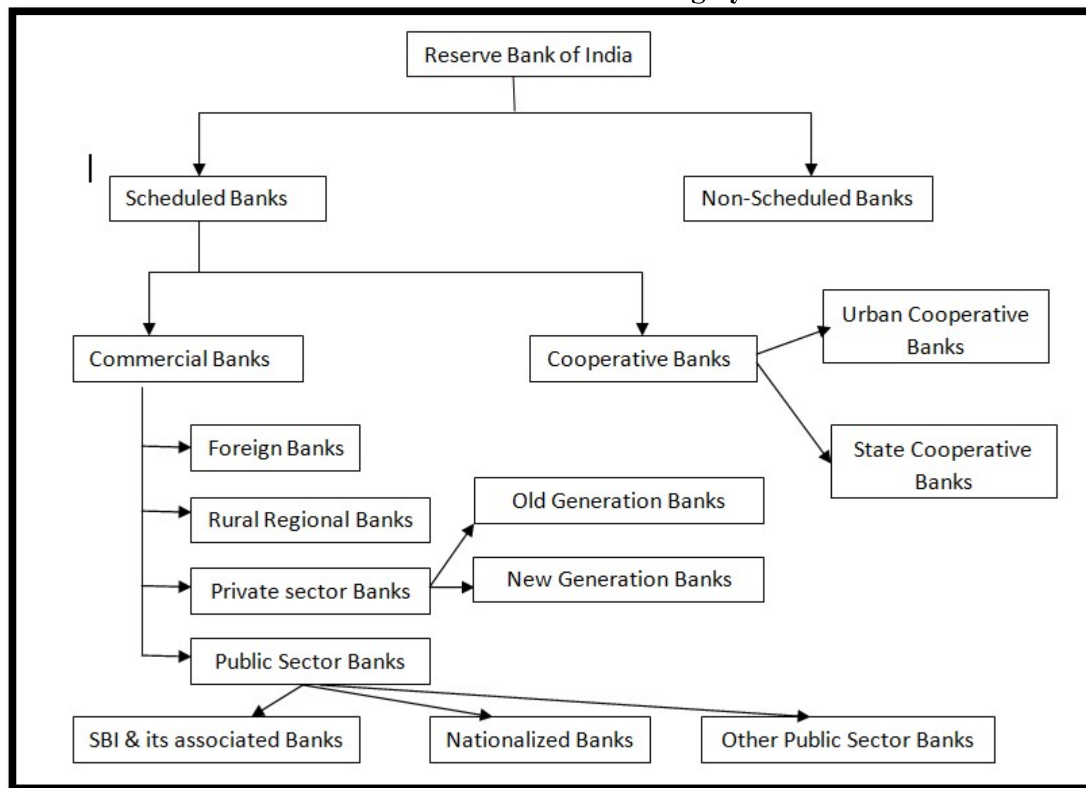
The banking structure in India is well organized and it is broadly divided into three categories namely –

1. Central bank i.e. Reserve Bank of India.
2. Commercial Banks
3. Co-operative banks.

The Indian banking system is totally regulated by Reserve Bank of India. Under the control of RBI, there are Scheduled Banks and non-Scheduled Banks. Schedule banks consist of commercial banks and cooperative banks. Scheduled commercial banks consist of foreign banks, regional banks, private and public sector banks.

A public sector bank consists of SBI and its associated banks, nationalized banks. Private sector banks consist of old and new generation banks. Scheduled cooperative banks consist of urban and state banks. Non- Schedule banks include the local area banks. This is the total structure of Indian Banking System. The same is depicted in the flow chart below.

Structure of Indian Banking System



1. Reserve Bank of India

Reserve bank of India which is the Central Bank of India was established in 1934 and started its operations from 1st April, 1935. RBI guides and regulates the banking system of our country. It has no relation with the general public. It acts as banker to banks, government, issues currency, regulates money circulation, keeps the deposits of commercial banks, and provides financial accommodation to them. As RBI guides the commercial banks it is known as bankers' bank. It maintains the government records relating to revenue and expenditure under various heads. It advises the government on monetary and credit policies and decides on the interest rates applicable to bank deposits and loans and advances. A detailed study of RBI's structure and functions will be dealt in another lesson.

The RBI acts as a regulator and supervisor of the overall financial system. This injects public confidence into the national financial system, protects interest rates, and provides positive banking alternatives to the public. RBI also acts as issuer of national currency. This provides with a supply of currency in the form of dependable notes and coins, a lingering issue in India. In 2018 the RBI banned the use of virtual currencies by the financial agencies and banks that it regulates. In the coming chapters a detailed study on RBI is done.

2. Scheduled banks

Scheduled banks are those banks which are included in the second Schedule of Reserve Bank of India Act 1934. For this inclusion, the banks have to comply with the criteria laid down vide Section 42(6) of the RBI Act. The paid-up capital and collected fund

of the bank should not be less than five lakh. In other words, these banks have a paid- up capital and reserves of an aggregate value of not less than five lakhs. It is a State Cooperative Bank.

Scheduled banks are of two types:

1. **Scheduled Commercial Banks** – These banks accept deposits and lend short term loans and advances to the customers. They are the bedrock of the Indian financial system and account for three fourths of the financial markets in the country. Their branches are available all over the country now. The branch networking of these banks is around one lakh now. The scheduled commercial banks are divided into three types. They are
   a. Public sector banks
   b. Private sector banks
   c. Foreign banks
   d. Regional rural banks.

2. **Scheduled cooperative banks** –These banks carry out the banking by following the principles of cooperation from the cooperative society under the Cooperative Societies Act. It is mandatory of these banks also to get RBI permission before starting the banking business. These banks follow the guidelines of RBI for their functioning and they function under the supervision of the Registrar and Cooperative Societies of the State. Their main customers are agriculturalists, small industrialists, retail and trade, self-employed traders in rural and urban areas. RBI and NABRD have taken many reform measures to improve the financial position of the cooperative banks. Cooperative banks can be either scheduled or non-scheduled. The scheduled cooperative banks can be divided into two types. They are :
   a. Urban Cooperative Banks
   b. Rural Cooperative Banks

- **Non-Scheduled banks**

They are the banks which are defined in the clause (c) of section 5 of Banking Regulation Act, 1949 (10 of 1949), they are not the scheduled banks. They function as local area banks. They have to follow the Cash Reserve Ratio condition but are not compelled to deposit these funds in RBI. Presently there are no non-schedule banks. Non-Scheduled banks are those which are not in the list of the second schedule of RBI ACT, 1934. Banks with a reserve capital of less than five lakhs are considered to be non-scheduled banks.

- **Commercial banks**

Commercial Banks play a vital role in directing affairs of the economy in various ways. Commercial banks in India are the backbone of all major economic activities in the country. The operations of Commercial banks record the economic pulse of the country. The size and composition of their transactions depicts the economic growth of the country. Economist, David Ricardo stated that a bank is a dealer in money in a financial system. It is the banks who set the tempo of aggregate economic activity in any economy. Commercial banks are profit making financial institutions. They accept deposits from the general public and advance loans to the households, entrepreneurs, businessmen etc. The functions and operations of all the commercial banks are regulated by RBI. Commercial banks main income source is the difference between the rate of interest they give for deposits and charge

for the loans. A detailed study regarding the commercial banks is in the coming chapter. Commercial banks in India are divided into the following:

a. Private sector banks – In these banks the majority of the stake is held by the private individuals. Eg. ICICI bank, IDBI bank, HDFC bank, etc.
b. Public sector banks - In these banks the majority of the stake is held by the government. Eg. SBI, Union Bank of India, Syndicate bank etc.
c. Foreign banks- The head office of these banks are located outside the country. Their origin and control is not in our country. Eg. Citi bank, Standard Chartered bank, etc.
d. Regional rural banks – They are the part of scheduled commercial banks operating at regional level. They have been established mainly to serve the rural areas of the country by providing basic banking and financial services.

- **Cooperative Banks**

Regional Rural Banks or RRBs are government banks operating at regional level in different states of the country. They are designed to cater the needs of the rural area people. Presently, there are 43 RRBs in India and each RRB is sponsored by Government of India along with State Government and Sponsor bank. Regional Rural Banks (RRBs) were set up under the provisions of 26th September, 1975 ordinance and the RRB Act of 197**6** to allocate banking and credit services for agriculture and other rural sectors. They were established on the recommendation of Narshimham Working Group. The regional rural banks are owned by three entities namely – central government, with a share of 50 percent, state government with a share of 15 percent and sponsor bank with a share of 35 percent. Sponsored bank can be any commercial bank. The main aim of any RRBs is to mainly provide banking facilities to the rural and semi-urban areas.

1.8 SUMMARY

A bank is an institution which deals with money and credit. It accepts deposits and advances loans to those who need them, and helps in the remittance of money from one place to another. Bank is a financial institution where the customers can save their money and also borrow. Banks also invest money in order to build their reserves of money. Banks are regulated by laws, which differ from country to country. The banking system constitutes the core of the financial sector. It plays a very vital role in the process of economic growth of the country. The transactions done with a bank and the services that is offered to the customers is collectively known as banking. Banking can be done either online or offline or in both ways. Every bank has primary and secondary functions to perform. The structure of Indian banking system is divided into three categories – central bank, commercial bank and cooperative banks.

The financial world relies on banking principles to maintain stability and functionality. Foundation of banking system lies in the unwavering commitment to safety and reliability. Banks stand responsible for safe guarding their customer's funds and investments. The main banking principles are: maintaining liquidity, balancing profitability, practicing prudence, upholding customer confidentiality, embracing diversification, transparency, fostering innovation, promoting financial inclusion, maintaining ethical standards, solvency.

1.9 KEY WORDS

Banking - Banking is the business of protecting money for others. Bank lend this money and generate interest which creates profits to the banks and its customers. A bank is a financial institution licensed to help its customers with deposits and loans.

Bank - A bank is an institution which deals with money and credit. It accepts deposits and advances loans to those who need them, and helps in the remittance of money from one place to another. Bank is a financial institution where the customers can save their money and also borrow. Banks also invest money in order to build their reserves of money. Banks are regulated by laws, which differ from country to country

Central Bank - The Reserve Bank of India is the central bank of our country. Each country has a central bank that regulates all the other banks in that particular country. Reserve bank of India which is the Central Bank of India was established in 1934 and started its operations from 1st April, 1935. RBI guides and regulates the banking system of our country. It has no relation with the general public. It acts as banker to banks, government, issues currency, regulates money circulation, keeps the deposits of commercial banks, and provides financial accommodation to them. As RBI guides the commercial banks it is known as bankers' bank

Cooperative Banks - These banks are organised under the state government's act. They give short term loans to the agriculture sector and other allied activities. The main goal of Cooperative Banks is to promote social welfare by providing concessional loans.

Scheduled banks - Scheduled banks are those banks which are included in the second Schedule of Reserve Bank of India Act 1934. For this inclusion, the banks have to comply with the criteria laid down vide Section 42(6) of the RBI Act. The paid-up capital and collected fund of the bank should not be less than five lakh. In other words, these banks have a paid- up capital and reserves of an aggregate value of not less than five lakhs. It is a State Cooperative Bank.

Commercial Banks - Commercial Banks play a vital role in directing affairs of the economy in various ways. Commercial banks in India are the backbone of all major economic activities in the country. The operations of Commercial banks record the economic pulse of the country. The size and composition of their transactions depicts the economic growth of the country.

1.10 SELF-ASSESSMENT QUESTIONS

Essay type questions

1. Define bank and explain the structure of Indian banking system.
2. What are the banking principles?
3. Write a note of banking structure in India.

Short type questions

1. What are the characteristics of banks?
2. State the importance of banks.
3. What are the functions of banks?
4. Define banking system in India.

1.11 SUGGESTED READINGS

1. Money and Banking	:	Robert e. Wright, NYU, 2012, Saylor foundation.
2. Indian Banking System	:	T. Avaswamy, Lavanya Publishing House Bombay, 1968
3. Practice and Law of Banking	:	Sheldon H.P
4. Banking in India	:	Pannandikar & Mithami.
5. Text Book of Banking	:	Radhaswamy&Vasudevan.
6. The Story of RBI	:	Rahul. B., Rupa Publications, India, 2018.
7. Introduction to Banking	:	Barbara Casu, Claudia Firardone and Philip Molyneux, Pearson, 2015.
8. Banking an Introduction	:	Indian Institute of Banking and Finance
9. Principles of Banking	:	Deendayal Sharma, Rajat Publications, 2009
10. Principles and Practices of banking	:	Macmillan education, IIBF

Dr.M.Syamala

LESSON – 2
REGULATIONS OF BANKING IN INDIA

Aims and Objectives:

- To understand regulations of banking system in India
- To understand the role of RBI
- To know the functions of RBI
- To understand para-activities of banks in India
- To know about corporate governance in the banking sector in India

Structure

2.1 Introduction
2.2 Regulations of Banking in India
2.3 Para- Banking Activities
2.4 Corporate Governance in the Banking Sector
2.5 Role and Functions of RBI
2.6 Summary
2.7 Key words
2.8 Self-Assessment Questions
2.9 Suggested Readings

2.1 INTRODUCTION

RBI is the central bank of India which plays a crucial role in the financial matters. It is the regulator and overseer of the financial system in the country. Indian financial system includes all the banks like commercial banks, regional rural banks, local area banks, cooperative banks, financial institutions, including development financial institutions and non-banking financial companies. The provisions in Banking Regulation Act of 1949 serve as the basis for the RBI for controlling the mechanisms for the Indian banking system. The RBI's supervisory functions has grown significantly since the 1990s as the Indian economy and banking underwent rapid change. The Board of Financial Supervision was established in 1994 to continue to be aware of the extra relevance of this capacity. Since that time, BFS has taken over as the main controlling force behind RBI's regulation and oversight functions. On March 16, 1949, the Banking Regulation Act of 1949 came into effect covering a variety of Indian banking-related topics.

The Act grants the Reserve Bank of India (RBI) the authority to license banks, regulate shareholder shareholding and voting rights, supervise the selection of board members and management, oversee bank operations, establish guidelines for audits, oversee moratoriums, mergers, and liquidations, issue directives on banking policy, and impose penalties. In this chapter we would discuss about all the ways and means followed by RBI in regulation of banking system in the county.

2.2 REGULATION OF BANKING IN INDIA

Requirements For License

To start or operate banking function it is necessary to get the permission from the RBI in India, whether it is at domestic or international level. The Branch Authorization Policy

governs branch openings. Currently, Indian banks no longer need a Reserve Bank permit to open a branch in a city with a population under 50,000. RBI ensures the following concepts for smooth operations of banks:

1. **Corporate Governance in Banks** - As part of its strategy, the RBI aims to ensure excellent corporate governance in banks. RBI has published recommendations for "fit and genuine" standards for bank executives. One of these rules states that bank directors must have special knowledge of or involvement in the many banking-related fields. Additionally, RBI may appoint additional directors to the board of a banking institution.
2. **Statutory Pre-emptions**- Every commercial bank is required to maintain a specific portion of its Net Demand and Time Liabilities, known as the Cash Reserve Ratio (CRR) and the Statutory Liquidity Ratio, as cash with the Reserve Bank and interest on endorsed securities, respectively (SLR).
3. **Interest Rates**- The interest rates on the vast majority of deposit and loan transaction classes are no longer regulated and are largely set by banks. The Reserve Bank controls the interest rates on the investment fund ledgers, NRI deposits, small advances up to two lakh rupees, send out credits, and a few different classes of advances.
4. **Prudential Norms**- It refers to ideal and reliable standards that banks upholds. To strengthen bank balance sheets, the RBI provides "Prudential Norms" for commercial banks to follow. Pay acknowledgment, asset arrangement and provisioning, capital sufficiency, investment portfolio, and capital market exposures are some of concept in this concern.
5. **Disclosure Norms**- Maintaining open disclosure of relevant data is one of the key tools for marketing discipline. The banks are mandated by the RBI to provide their annual reports and various records regarding their capital sufficiency, asset quality, liquidity, income angles, and fines levied against them by the regulator.
6. **Anti-Money Laundering Norms-** KYC standards (Know Your Customer) are some of the important issues on which the RBI continues to produce its standards and guidelines include anti-money-laundering and combating the financing of terrorism recommendations.
7. **Protection of Small Depositors**- To protect the interests of small depositors in the case of bank failure, the RBI established the Deposit Insurance and Credit Guarantee Corporation (DICGC). All eligible bank depositors are insured by the DICGC up to Rs. 1 lakh per investor per bank.

2.3 PARA-BANKING ACTIVITIES

Activities that don't fall under the category of regular banking activities are referred to as Para banking activities. Asset management, mutual funds, insurance, merchant banking, factoring, venture capital, the card industry, equity investment in venture funds, and leasing are some of these operations. RBI had given banks permission to engage in these operations.

RBI conducts yearly on-site bank inspections to evaluate the health of their finances and their performance in terms of management style, capital adequacy, asset quality, income, liquidity situation, and internal control systems. As a result of the inspection's findings, banks

are now subject to supervisory reviews. Off Site Surveillance and Monitoring System is referenced by OSMOS. Under OSMOS, the RBI anticipates that banks would send detailed and structured information on a regular basis.

2.4 CORPORATE GOVERNANCE IN THE BANKING SECTOR

The Reserve Bank of India is responsible for overseeing corporate governance in India. The RBI which is the central bank of our country regulates all matters pertaining to money, foreign exchange reserves, and other financial concepts. RBI is the institution in charge of securing India's monetary stability. With a view to ensuring monetary stability in the country and operating the currency or credit system of the central bank is necessary. Banks are the back bone to stabilize any economy. In this operation of the bank fails, then it is not just the bank but it wipes out all the account holder's life time savings and investments.

Corporate governance is also necessary for the bank to be aware of money laundering, supporting illegal and criminal activity, and money transfers to frightened parties. Demonetization is the RBI's most recent example of its work in the Indian economy; through it, it has severely hit the general public who store illicit funds. Corporate governance is developed and carried out in large part by RBI.

RBI has built corporate governance system on three categories for managing banks. They are:

(i) Disclosure and transparency,
(ii) Off-site surveillance,
(iii) Prompt Corrective Action.

2.4.1 Disclosure and Transparency - The most crucial aspect of corporate governance is openness and transparency. The RBI keeps an eye on the operations being attempted by the Indian banks due to the requirement of routinely disclosing financial transactions of the bank. Any failure to comply with the conditions outlined by the RBI may result in the imposition of heavy fines and the cancellation of the license to operate as a bank. By this bank will not have a chance to disappear with the long-term assets and reserve dues of the general public.

2.4.2 Off-site surveillance: To improve banking governance, RBI conducts an annual on-site check of the records of the banks. Off-site surveillance for bank residential operations was introduced in 1995 by the RBI. Between two on-site inspections, the main goal of off-site surveillance is to keep an eye on banks' financial health and identify any that show signs of deterioration that might raise supervisory concerns. Off-site observation prepares RBI to take prompt remedial action before matters get out of control.

2.4.3 Prompt Corrective Action: The banks must implement a structured action plan also known as obligatory action plan based on the activate objectives established by RBI. RBI also has discretionary action plans in addition to mandatory action plans. The main justification for classifying the standard-based action targets into Mandatory and

Discretionary is that while some actions are necessary to restore the financial stability of banks and must be taken by the bank mandatorily, other actions will be taken at the RBI's discretion based on the profile of each bank.

The RBI is criticized for using the prompt corrective action (PCA) procedure for banks too strictly. State-owned banks have been subject to prompt corrective action because they fell short of the RBI's predetermined standards for capital sufficiency, asset quality, or profitability. The rationale for this is that banks must maintain sufficient cash reserves while lending. Analysis shows that the central bank has signaled abstinence with some of the institutions that are not effectively under PCA, far from being overly strict. If RBI adopts a strict guideline-based technique, then many banks be rejected for failing to achieve the set risk levels by the central bank. If any of the risk thresholds for capital, asset quality, profitability, or use are breached, RBI expressly decides that PCA may be applied. While the Indian banking system has improved its detection of NPAs (non-performing assets), provisioning standards are still conservative. NPA provisioning standards are becoming stricter in places where the PCA structure only takes capital ratios into account. Perhaps the RBI's restraint stems from its hope that the legislature would recapitalize these banks so that the provisioning for their NPAs won't cause their capital to fall to dangerously low levels.

2.5 ROLE AND FUNCTIONS OF RBI

Commercial banks carry out many tasks like receiving deposits, advancing loans, and marketing. These are primary functions of a bank. General utility services are a secondary purpose of commercial banks' agency services. Public, private, regional rural banks, and foreign banks are the four different types of commercial banks. Public banking was once more divided into two categories: nationalized banks and the State Bank of India. Private banks' services were improved by commercial banks. All these bank work under the control and guidelines stated by RBI.

Functions of RBI

The Preamble of the Reserve Bank of India describes the basic functions of the Reserve Bank as: "to regulate the issue of Bank notes and keeping of reserves with a view to securing monetary stability in India and generally to operate the currency and credit system of the country to its advantage; to have a modern monetary policy framework to meet the challenge of an increasingly complex economy, to maintain price stability while keeping in mind the objective of growth." The following points highlight the seven main functions of the RBI. The functions are:

1. Monopoly of Note Issue
2. Banker's Bank
3. Banker to the Government
4. Controller of Credit
5. Exchange Management and Control
6. Monetary policy of the RBI
7. Miscellaneous Functions
8. Promotional and Developmental Functions

1. **Monopoly of Note Issue -** Like any other central bank, the RBI acts as a sole currency authority of the country. It issues notes of every denomination, except one-rupee note and coins and small coins, through the Issue Department of the Bank. One-rupee notes and coins and small coins are issued by the Government of India. In actuality, the RBI also issues these coins on behalf of the Government of India. At present, notes of denominations of rupees two, five, ten, twenty, fifty, one hundred and five hundred are issued by the RBI. Prior to 1956, the principle of note issue of the RBI was based on proportional reserve system. This system was replaced by the minimum reserve system in 1956 under which the RBI was required to hold at least Rs. 115 crores worth of gold as backing against the currency issued. The rest (Rs. 85 crores) should be in foreign securities, so that together with gold and foreign exchange reserve the minimum value of these assets is Rs. 200 crores.

   The RBI has the exclusive right, authority, or monopoly to issue currency notes and coins of smaller denominations that are not one-rupee notes and coins. The banks publish notes with the following values: 2, 5, 10, 20, 50, 100, 500, and 1000. The RBI issues rupee coins, exchange bills, and promissory notes as collateral for gold bullion, foreign securities, and other securities. Recently, the RBI modified banknotes.

2. **Banker's Bank -** The RBI are also known as the central bank or the banker's bank. central banks and cooperative banks' relationship and a vital component of the company. It retains a portion of commercial banks' deposits and serves as a lender of last resort by giving banks money.

3. **Banker to the Government -** The RBI is a banker under Sections 20 and 21-A since it offers the government all banking services, including accepting deposits, withdrawing money, issuing checks, and making payments as well as receiving and collecting money. It offers strategies for advancement. Section 17 of the Government's Subsection 5. As the Government's banker, the RBI provides short-term credit to the Government of India. This short-term credit is obtainable through the sale of treasury bills. Not only this, the RBI also provides ways and means of advances (repayable with 90- days) to State Government. It may be noted that the Central Government is empowered to borrow any amount it likes from the RBI.

   The RBI also acts as the agent of the Government in respect of membership of the IMF and World Bank. Furthermore, the RBI acts as the adviser of the Government not only on banking and financial matters but also on a wide range of economic issues (like financing patterns, mobilization of resources, institutional arrangements with regard to banking and credit matters, arrangements with regard to banking and credit matters, international finance) etc.

4. **Controller of Credit -** The RBI controls the total supply of money and bank credit to sub serve the country's interest. The RBI controls credit to ensure price and exchange rate stability. To achieve this, the RBI uses all types of credit control instruments, quantitative, qualitative and selective. The most extensively used credit instrument of the RBI is the bank rate. The RBI also relies greatly on the selective methods of credit control. This function is so important that it requires special treatment.

   A certain percentage of the assets are kept liquid by the RBI as required by law. and cash retention ratio. These two tools are used to control credit. Since 1962, a separate CRR was fixed in respect of demand liabilities, which was set at 5%, and time liabilities, which was set at 2%. This is known as the cash reserve ratio (CRR), which refers to the cash that

banks have maintained with the RBI as a certain percentage of their demand and time liabilities. In 2024, February, CRR is 4.50 percentage. SLR was first established in 1980 when the cost of refinancing increased. Present rate for SLR in Feruary, 2024 is 18 percent.

5. **Exchange Management and Control-** One of the essential central banking functions performed by the Bank is that of maintaining the external value of rupee. The external stability of the currency is closely related to its internal stability the inherent economic strength of the country and the way it conducts its economic and monetary affairs. Domestic, fiscal and monetary policies have, therefore, an important role in maintaining the external value of the currency. Reserve Bank of India has a very important role to play in this area. The RBI has the authority to enter into foreign exchange transactions both on its own account and on behalf of the Government. The official external reserves of the country consist of monetary gold and foreign assets of the Reserve Bank, besides SDR holdings. The Reserve Bank, as the custodian of the country's foreign ex- change reserves, is vested with the duty of managing the investment and utilisation of the reserves in the, most advantageous manger.

   The RBI's primary duty is to regulate international markets and manage the stability of domestic policy on foreign exchange. The RBI sets foreign exchange change rules. RBI oversaw exchange operations. with global financial organisations including the Asian bank, world bank, and IMF (international monetary Fund). In 1973, the RBI Control Foreign Regulation Act of 1947 was replaced. The foreign capital account convertibility and gradually liberalising capital account operations are primarily under control by the Foreign Exchange Management Act.

6. **Monetary policy of the RBI -** In order to achieve the goals of general economic policy, monetary policy is described as a policy and a central source of money. Economic growth, price stability, maintaining exchange rate stability, balance of payments, and full employment are the primary goals of the monetary system two forms of monetary policy measures

   1. qualitative measures
   2. quantitative measures.

The daily inflation and deflation of prices are managed by monetary policy. Income and wealth disparities are eliminated by easy monetary or pricey money policies. Price stability is monetary policy's primary goal. The goal of monetary policy is economic growth. if the economy grows and prices and incomes remain stable. Financial stability is necessary for the business and economic life to improve welfare. Monetary policy supports the growth of the market's financial infrastructure and makes it possible for it to function effectively. Monetary policy helps small and medium-sized businesses grow. Balance of Payment, which was first adopted in 1950, has reached equilibrium. Financial transactions can be properly and correctly carried out thanks to monetary policy's maintenance of an equal payments system. A country's developed economy, financial stability, and price stability are all maintained by monetary 10 policy. The most significant agriculture, villagers, and small businesses are found in emerging nations. It also improves loan availability.

Selective Methods- Qualitative methods, or selective methods, are another name for them. The issues raised above have a broad impact on every area of the economy. They are, in order, as follows:

(a) Credit Rationing- The RBI grants some predetermined amount certain purposes as part of the credit rationing system, which controls and regulates the usage of bank credit. For commercial banks, it offers more loans and advances than anything else.

(b) Margin Requirement- The percentage of a loan that is not covered by a bank is known as the margin requirement. It is a portion of the loan that a borrower must incur in order to obtain financing for his or her purposes. The margin requirement directly affects the lender when the borrower maintains a low volume of credit.

(c) Licensing- The RBI makes sure that the cause of regional development is served properly as a result of this incidence. the granting of a licence to start a banking operation in India the RBI The RBI began issuing loans after Independence.

General Methods- General Methods or quantitative methods can be summed up as follows-

(a) Bank Rate- The bank rate, often known as the discount rate, is the most traditional form of monetary policy. The RBI offers loans, rediscounts on bills of exchange, and promissory notes as financial accommodations. 1961–1960 bank rate is 6.3. The bank rate in 1960–1964 is 5%. bank rate for 1964–1975. Was raised with a 5–9% degree of uncertainty. Bank rates increased by 7% between 1989 and 1990 and by 2% between 1991 and 1996. 10 to 6% less was reduced between 1997 and 2004 and in 2024, February it is 6.75%

(b) Open Market Operations- In the US, the UK, and many other nations, open market activities are used to control money. This monetary policy approach is very productive and well-liked. Treasury bills, state and federal government securities, and other securities. The RBI directly purchased these securities. Purchase and sale of government and corporate shares.

(c) Repo Rate- Repo Rate is the rate at which RBI raises its borrowing costs. home loan interest rates typically decrease. If the repo rate is short on money, you can borrow it. The usual collateral for the loans the RBI makes to commercial banks is government securities. Current repo rate for February 2024 is 6.50%.

(d) Liquid Adjustment Facility- One tool for monetary policy is the liquidity adjustment facility. bank loans are made possible through repurchase agreements at repo rates. A new technique for managing short-term liquidity is the liquidity adjustment facility.

7. **Supervising Authority -** The RBI has additional authority to monitor and manage commercial and cooperative banks in order to create a sufficient, better banking system. The RBI grants licenses for a variety of Indian foreign banks, including those that are newly established. When the RBI separated its conventional central banking responsibility of overseeing banks in 1993, it took control of the nomination of the committee's chairman, chief executive officer, and members from private sector banks. Non-banking financial firms (NBFCs) were first registered in November 1995, and oversight of those entities began in July 1995.

8. **Promotional and Developmental Functions** - Addition to carrying out its duties, the RBI also serves as a development and promotion agency, strengthening the nation's banking and financial system. Promotional activities aid in saving money and reducing credit flows in the correct directions to fulfil the goal of economic development. Major function of RBI is to build a money market, a commercial banking system, and a promotional market. promoting roles in several financial systems, including industrial finance and credit distribution.

(a) Money Market- The RBI-controlled money market has consistently worked for the banking system's combined un- and-original sector main stream. Money markets raise the standard of financing they offer. Bill Market Scheme was founded in 1952 with the intention of providing loans to the commercial banks. The RBI created a new bill market system covering the money market in 1970. This was followed by an increase in RBI strength, better amplifications, and mergers of weak banks with strong ones.

(b) Agricultural Sector- The primary goal of market promotion is to develop the agriculture industry. direct credit flows to the agricultural industry. since 1955, when a deputy governor was assigned to oversee rural credit, it has improved. The study of rural development has been started. the first time in 1954 by undertaking a rural credit survey over all of India. was created in 1986, and since then, the cooperative banking industry has offered loans, loan monitoring, and funding. It makes loans for the agricultural sector, both short- and long-term.

(c). Industrial Finance- The role of the RBI in repurposing the industrial infrastructure to fund small, medium, and big businesses as well as the export industry difficulties with short-term and long-term loans involving money The RBI is just as significant as other financial institutions and all other sectors of special development at the federal and state levels.

(d). Credit Delivery- The financial system's ability to deliver credit and provide services has improved thanks to the credit development, which has primarily benefited geographically present industrial institutions. by implementing regulations in 1977 regarding the transfer of borrowers' loan accounts.

2.6 SUMMARY

The RBI was created in 1934, and operations began with an eye on the development of various banks in India's business, agricultural sector, financial, and economic sectors. The RBI is a non-political organisation that oversees the nation's finances. It offers loans for the development of buildings and the provision of accessible, inexpensive financial services in the productive, infrastructure, and educational sectors. It consistently takes an active part in promoting effective customer satisfaction. banking services diversification in the banking business. Every year in the month of April, the RBI announces its monetary policy and conducts three quarterly reviews in July, October, and January. It has various functions. alternate source of credit in the economy that uses money. working of commercial banks' nonbanking financial profit motive and enhance cooperative banks. The Act grants the Reserve Bank of India (RBI) the authority to license banks, regulate shareholder shareholding and voting rights, supervise the selection of board members and management, oversee bank operations, establish guidelines for audits, oversee moratoriums, mergers, and liquidations, issue directives on banking policy, and impose penalties. In this chapter we would discuss about all the ways and means followed by RBI in regulation of banking system in the county.

2.7 KEY WORDS

1. **Para banking activities -** Activities that don't fall under the category of regular banking activities are referred to as Para banking activities. Asset management, mutual funds, insurance, merchant banking, factoring, venture capital, the card industry, equity investment in venture funds, and leasing are some of these operations. RBI had given banks permission to engage in these operations.

2. **Banker's Bank -** The RBI are also known as the central bank or the banker's bank. central banks and cooperative banks' relationship and a vital component of the company. It retains a portion of commercial banks' deposits and serves as a lender of last resort by giving banks money.

3. **Selective Methods**- Qualitative methods, or selective methods, are another name for them. The issues raised above have a broad impact on every area of the economy. They are, in order, as follows:
   (a) Credit Rationing
   (b) Margin Requirement
   (c) Licensing

4. **General Methods**- General Methods or quantitative methods can be summed up as follows-
   (a) Bank Rate
   (b) Open Market Operations
   (c) Repo Rate
   (d) Liquid Adjustment Facility

5. **Repo Rate-** Repo Rate is the rate at which RBI raises its borrowing costs. home loan interest rates typically decrease. If the repo rate is short on money, you can borrow it. The usual collateral for the loans the RBI makes to commercial banks is government securities. Current repo rate for October 2018 is 6.25%.

6. **Bank Rate-** The bank rate, often known as the discount rate, is the most traditional form of monetary policy. The RBI offers loans, rediscounts on bills of exchange, and promissory notes as financial accommodations. 1961–1960 bank rate is 6.3. The bank rate in 1960–1964 is 5%. bank rate for 1964–1975. Was raised with a 5–9% degree of uncertainty. Bank rates increased by 7% between 1989 and 1990 and by 2% between 1991 and 1996. 10 to 6% less was reduced between 1997 and 2004 and in 2024 it is 5.15%

2.8 SELF-ASSESSMENT QUESTIONS

Long question answers

1. Write a not on regulations of banking system in India.
2. What is the role of RBI?
3. What are the functions of RBI?
4. Explain corporate governance in the banking sector in India.

Short question answers

1. What are para banking activities?

2. Write short note on:
    b. CRR
    c. SLR
    d. Repo- rate
    e. Open market operations
3. Write a note on RBI
4. How does RBI control the credit system in the economy?

2.9 SUGGESTED READINGS

1. Agarwal, O.P "Modern banking of India", Himalaya Publishing house, New Delhi, 2015
2. Rahul Bajoria, "The story of Reserve Bank of India", Edward & Eagar Publications (2018)
3. The Reserve Bank of India (Part – A and Part-B) RBI Press.
4. Mithani, D.M., "Money, Banking and International Trade", Himalaya Publishing House, New Delhi, 2009
5. Parameswaran., R, "Indian Banking", S. Chand Publications, New Delhi, 2009
6. RBI Functions and working, RBI Publications, 2020
7. Impact of monetary policy Himalaya publication books house Bombay in the year (1985).

Dr.M.Syamala

LESSON – 4

ANTI-MONEY LAUNDERING (AML)

Aims and Objectives:

- To understand the concept of money laundering, the stages and techniques.
- To understand as what is Anti- money laundering
- To know as the history of AML and laws & regulations in India
- To understand PMLA regulations and KYC concept.

Structure

3.1 Introduction
3.2 Money Laundering
3.3 The Three Key Stages of Money Laundering
3.4 Common Techniques of Money Laundering
3.5 Anti-Money Laundering (AML)
3.6 History of AML
3.7 Role of AML Regulations in India
3.8 AML Laws & Regulations in India
3.9 PMLA Regulations in India
3.10 Know Your Customer (KYC) Checks
3.11 Strategies to Prevent Money Laundering
3.12 AML Compliance
3.13 Summary
3.14 Key words
3.15 Self-Assessment Questions
3.16 Suggested Readings

3.1 INTRODUCTION

Money laundering can be understood as the process of transforming illegally obtained funds into seemingly authentic assets, making it difficult to trace the true source of the funds and use them for criminal activities. Money laundering is a crime that conceals the origins of illegally obtained funds, making them appear valid. It involves three distinct stages: placement, layering, and integration. Common techniques include cash smuggling, shell companies, and real estate investments. Anti-Money Laundering (AML) regulations are essential for effective prevention with Know Your Customer (KYC) checks being critical to comply with these rules.

Anti-Money Laundering (AML) refers to the activities financial institutions accomplish to achieve compliance with legal requirements to actively monitor for and report suspicious activities. AML refers to legally recognized rules for preventing money laundering. It refers to the collection of laws, law enforcement, processes, and regulations that prevent illegally obtained money from entering the financial system. Customer due diligence (CDD) refers to practices financial institutions implement to detect and report AML violations.

In this chapter we would discuss about money laundering, the three stages and common techniques. Further Anti money laundering concept is discussed along with its historical evolution, rules and regulations. AML strategies and compliance is also discussed.

3.2 MONEY LAUNDERING

Money laundering is the process of illegally conceal the origin of money, obtain from illicit activities such as drug trafficking, corruption, embezzlement or gambling by converting it into a legitimate source. Best examples of money laundering re – cash earned illegally from selling drugs may be laundered through highly cash intensive businesses such as a restaurant where the illegal cash is mingled with business cash before deposit. Common techniques include cash smuggling, shell companies and real estate investments.

Money laundering is a term that conjures images of shadowy figures and underground criminal networks. Understanding the money laundering stages is crucial not only for businesses and financial institutions but for every individual who wants to protect their hard-earned money and maintain the integrity of the global financial system. Money laundering is a crime that conceals the origins of illegally obtained funds, making them appear valid. It involves three distinct stages: placement, layering, and integration. Common techniques include cash smuggling, shell companies, and real estate investments. Anti-Money Laundering (AML) regulations are essential for effective prevention with Know Your Customer (KYC) checks being critical to comply with these rules.

Money laundering is a financial crime that affects individuals, businesses, and entire economies. At its core, it is the process of concealing the origins of illicitly obtained funds, making them appear legitimate and covering their connection to criminal activities. The money laundering process enables criminals to integrate illegal funds into the genuine financial system, making it difficult for law enforcement and financial regulators to trace and grab these funds.The global nature of modern finance has only made money laundering more challenging to battle. Criminals exploit the interconnectedness of financial systems, frequently moving cash abroad and utilizing multiple foreign bank accounts and complex transactions to evade detection by tax authorities and financial regulators.

In simple language money laundering can be understood as the process of transforming illegally obtained funds into seemingly authentic assets, making it difficult to trace the true source of the funds and use them for criminal activities.

The consequences of money laundering extend far beyond the criminals who profit from it. Money laundering allows criminal organizations to finance their operations and grow their influence, posing a threat to public safety and national security. Additionally, money laundering undermines the integrity of financial systems, as it allows criminals to exploit loopholes and weaknesses in regulations, ultimately eroding trust in financial institutions. On an economic level, money laundering can discourage investment and hinder economic growth by reducing the availability of capital and fostering instability in the financial system.

3.3 THE THREE KEY STAGES OF MONEY LAUNDERING

It is crucial to understand the three stages of money laundering –for comprehending how this crime operates and how to prevent it. It gives a comprehension picture as how the

illicit fund typically traverse is fundamental to effectively tackling money laundering. These stages serve to conceal the origin of the funds, make them difficult to trace, and ultimately enable criminals to use the money for illegal purposes without detection. The stages of money laundering-

1. **Placement–** It is movement of funds from direct association with the crime. The placement stage marks the beginning of the money laundering process where dirty money is introduced into the financial system. This stage is considered the most vulnerable for criminals, as they must find ways to deposit large amounts of cash without raising suspicion. Common ways used during placement includes-
   - Depositing cash in smaller amounts to avoid detection which is known as structuring
   - Purchasing monetary instruments like checks or money orders.
   - Channeling money through cash businesses such as casinos.

   Once criminals successfully inject illicit funds into the financial system, they initiate the process of concealing their origins and laundering the money.

2. **Layering -** Layering is the second stage of the money laundering stages in which criminals engage in a series of transactions to create confusion and distance the funds from their criminal origin. This can involve**:**
   - Transferring money between multiple bank accounts, often in different jurisdictions
   - Using shell companies
   - Using digital currencies to further ambiguous the money trace

   The objective of layering is to create a complex web of financial transactions that makes it extremely difficult for law enforcement to trace the source of the illicit funds. Criminals can further shield themselves from detection and prepare to reinfuse their laundered funds into the legitimate economy after successfully traversing the layering stage.

3. **Integration - Integration** is the final stage of the money laundering process, in which the laundered money is reintroduced into the legitimate financial system, often through investments in real estate, luxury assets, or business ventures. At this point, the funds appear to have been acquired from legitimate sources, making it difficult for authorities to distinguish between legal and illegal assets.Successful integration allows criminals to use their laundered money for further criminal activities or to fund their personal lifestyles with minimal risk of detection. Here in this stage the need and importance of vigorous anti money laundering controls and vigilance in monitoring transactions for tracking possible money laundering.

3.4 COMMON TECHNIQUES OF MONEY LAUNDERING

Money launderers employ a variety of money laundering schemes to achieve their goals, often adapting and refining their methods in response to changes in regulations and law enforcement practices. Some of the most common techniques include cash smuggling, shell companies, and real estate investments. These techniques exploit vulnerabilities in the financial system and enables criminals to conceal the origins of their illicit funds.

1. **Cash Smuggling -** It involves physically transporting large amounts of cash across international borders, with the aim to deposit the money in foreign banks or invest it in assets that are less likely to be inspected by authorities. To control such activities tough AML policies should be introduced, large cash transactions should be monitored, employees should be educated on the risks and warn them the consequences of such activities.

2. **Shell Companies -** Shell companies are non-operational entities created to hide the true ownership of assets and facilitate money laundering transactions. These companies often have no physical presence or employees and are used to obscure the identity of the individuals or organizations behind the company, making it difficult for authorities to trace the source of the funds and hold the criminals accountable.To deter money laundering through shell companies, businesses can implement comprehensive AML policies, monitor transactions, and provide employee training and awareness.

3. **Real Estate Investments -** Real estate investments are an attractive path for money laundering, as they provide a means of disguising the origin of funds and converting illicit cash into seemingly legitimate assets. By purchasing properties with illegal funds and later selling them for a profit, criminals can effectively launder their money and reintegrate it into the legitimate financial system.The large sums of money involved in real estate transactions hide their illicit gains and generate further profits.

3.5 ANTI-MONEY LAUNDERING (AML)

Anti-Money Laundering (AML) refers to the activities financial institutions accomplish to achieve compliance with legal requirements to actively monitor for and report suspicious activities.AML refers to legally recognized rules for preventing money laundering. It refers to the collection of laws, law enforcement, processes, and regulations that prevent illegally obtained money from entering the financial system. Customer due diligence (CDD) refers to practices financial institutions implement to detect and report AML violations.

AML targets a wide variety of crimes, from corruption and tax fraud to market manipulation and illicit trade and financing of terrorism, as well as efforts to mask these activities as the source of money. Because most criminals and terrorists rely significantly on laundered money for their illegal operations, having effective AML procedures in place has broader crime-reducing consequences. Failure to comply with AML standards can result in financial penalties and, in extreme cases, disqualification as a business/director. Financial institutions are the most prominent users of AML legislation, as they are compelled to report any suspicious behavior to authorities. They are at risk of money laundering since they provide credit to consumers who open accounts with the company.

3.6 HISTORY OF AML

The Bank Secrecy Act (BSA), established in the United States in 1970, was a pioneering to fight against money laundering. It has been continually updated and strengthened, with the Financial Crimes Enforcement Network (FinCEN). In 1989, the Global Financial Action Task Force (FATF) was formed by a group of governments and organizations. Its aim was to develop and promote international standards for preventing money laundering. The International Monetary Fund (IMF), plays a crucial role about the impact of money laundering and similar crimes on the integrity and stability of the financial sector and the broader economy.

The Indian Parliament passed the Prevention of Money Laundering Act in 2002. The main purpose was to prevent any money-laundering activities in the India. As per the anti-money laundering act's provisions, the property purchased from black money will be labeled as an asset of money laundering. In this regard Section 12 (1) describes the obligations that banks and other financial institutions have to follow:

(a) Timely maintenance of records that give every possible detail about the transaction, irrespective of the fact that it is a single transaction or a series of transactions that are connected and have taken place recently.
(b) Furnish information to the right authority.

Section 12 (2) prescribes the time duration, and the information about the transaction should be recorded and maintained regularly. These duties are fulfilled by the Income Tax Department of India. The provisions of the Act have undergone multiple amendments at regular intervals. As per the Indian Government, India's total tax arrears are more than ₹2,480 billion. If the pending cases on money laundering and securities scam cases are solved then more than ₹1,300 billion amount would be released into the money market. The PMLA became law and came into force on 1st July 2005.

The evolution of money laundering, conventional frauds, technological schemes made it necessary for regulatory bodies to fortify AML regulations in India. The regulatory developments has shaped India's AML landscape and to meet the threats of money laundering more effectively. Evolution of AML has witnessed the establishment of specialized agencies which would restrict money laundering activities and other offences. The main agencies which were established are:

1. **Enforcement Director** - It emerged as a vital part which is entrusted with enforcing economic laws and addressing economic offenses. It became the legal entity responsible for initiating actions offender and ensuring the confiscation of wrongful assets.
2. **Financial Intelligence Unit of India** – It assumed the role of collecting, processing and disseminating data which is related to suspicious financial transactions. It works under department of Revenue and Ministry of fiancé. It serves as the primary national body which is responsible for sharing vital financial information with law enforcement agencies.

The Directorate of Enforcement is a multi-disciplinary organization mandated with investigation of offence of money laundering and violations of foreign exchange laws. The statutory functions of the Directorate include enforcement of following Acts:

1. The Prevention of Money Laundering Act, 2002 (PMLA): It is a criminal law enacted to prevent money laundering and to provide for confiscation of property derived from, or involved in, money-laundering and for matters connected therewith or incidental thereto.
2. The Foreign Exchange Management Act, 1999 (FEMA): It is a civil law enacted to consolidate and amend the laws relating to facilitate external trade and payments and to promote the orderly development and maintenance of foreign exchange market in India. ED has been given the responsibility to conduct investigation into suspected contraventions of foreign exchange laws and regulations, to adjudicate and impose penalties on those adjudged to have contravened the law.

3. The Fugitive Economic Offenders Act, 2018 (FEOA): This law was enacted to deter economic offenders from evading the process of Indian law by remaining outside the jurisdiction of Indian courts. It is a law whereby Directorate is mandated to attach the properties of the fugitive economic offenders who have escaped from the India warranting arrest and provide for the confiscation of their properties to the Central Government.

4. The Foreign Exchange Regulation Act, 1973 (FERA): The main functions under the repealed FERA are to adjudicate the Show Cause Notices issued under the the said Act upto 31.5.2002 for the alleged contraventions of the Act which may result in imposition of penalties and to pursue prosecutions launched under FERA in the concerned courts.

5. Sponsoring agency under COFEPOSA: Under the Conservation of Foreign Exchange and Prevention of Smuggling Activities Act, 1974 (COFEPOSA), this Directorate is empowered to sponsor cases of preventive detention with regard to contraventions of FEMA.

3.7 ROLE OF AML REGULATIONS IN INDIA

With growing threat of money laundering, governments and regulatory bodies around the world have introduced anti-money laundering (AML) regulations designed to fight this financial crime. These regulations play a critical role in detecting, preventing, and reporting money laundering activities, helping to maintain the integrity of the financial system and protect businesses and individuals from the negative impacts of illicit funds. The following are some of the regulators that have been proactive in AML framework:

1. **Reserve Bank of India** – RBI took a proactive stance in combating money laundering and establishing KYC. It has also given AML guidelines for banks and financial institutions. These guidelines are mandated rigorous due diligence procedures, customer profiling and transaction monitoring to identify and prevent suspicious activities.
2. **Security and Exchange Board of India -** SEBI is a regulatory authority that oversees the securities market. IT introduced comprehensive KYC and guidelines for financial intermediaries and investors. By mandating strict customer verification SEBI aims to create a secure environment within the securities sector to prevent illicit financial activities.
3. **Insurance Regulatory and Development Authority of India –** IRDAI has taken up the task of curbing money laundering to ensure the integrity of the insurance industry. It established specific AML regulations targeting classes of insurers, thereby contributing to the control financial crimes and financing terrorism.

3.8 AML LAWS & REGULATIONS IN INDIA

Money laundering is a common issue around the globe. In recent times, money laundering and terror financing have forced several governments and regulators globally to focus on stopping the illegitimate flow of funds. However, combating this problem remains a primary challenge for nations and financial institutions all over the world.

AML in India is described as a set of regulations, laws or procedures particularly designed to prevent the activity of generating money via illegal ways and methods. The Prevention of Money Laundering Act, 2002 (PMLA) along with the Prevention of Money Laundering (Maintenance of Records) Rules, 2005 are the principal laws that are enforced to prohibit money laundering activities in India. There are specialized authorities that deal with

the money laundering problems such as the Reserve Bank of India/ Securities and Exchange Board of India (SEBI)/ Insurance Regulatory and Development Authority of India that lay down guidelines on anti-money laundering standards following PMLA and Rules as discussed in the above paras.

The Financial Action Task Force on Money Laundering (FATF), an intergovernmental body introduced by the G-7 Summit in Paris in 1989 and responsible for setting global standards on anti-money laundering and combating the financing of terrorism explains money laundering as the processing of criminal proceeds to disguise their illegitimate origin to legitimize the illegal gains of crime. In 2010, India became the 34th nation member of the Financial Action Task Force. India is one of the signatories to several United Nations Conventions which tackle anti-money laundering and countering the financing of terrorism. India has prohibited money laundering under the Prevention of Money Laundering Act, 2002 (PMLA) and also in the Narcotic Drugs and Psychotropic Substances Act, 1985 (NDPS Act) (amended in 2001).

Prevention of Money Laundering Act, 2002

In 1998, The Prevention of Money Laundering Bill was introduced in the Lok Sabha, passed in 2003 and came into force in 2005. It has gone through several amendments, with the last one being in 2019. Administration and enforcement authorities are chosen under PMLA to execute its provisions and rules. The PMLA attempts to combat acts related to money laundering in India, it has three main objectives i.e.

(i) To prevent and control money laundering
(ii) To confiscate and seize the property acquired from the laundered money
(iii) To deal with any other issue in relation to money laundering in India.

Under the provisions of the PMLA, the Financial Intelligence Unit of India (FIU-IND) was formed in 2004 as the primary body for coordinating India's AML efforts. The primary function of FIU-IND is to receive, analyses, process and disseminate information relating to suspect financial transactions, fight against money laundering and financing of terrorism. In 2005, the Enforcement Directorate (ED) was introduced by the Government of India to utilize exclusive powers related to the investigation and prosecution under PMLA. The primary legislation other than the Prevention of Money Laundering Act, 2002, which directly or indirectly focuses to curb and fight money laundering activities are as follows:

1. **The Conservation of Foreign Exchange and Prevention of Smuggling Activities Act, 1974** - The act was passed in 1974 in furtherance to the government attempt to retain foreign exchange within the nation. The Act is established on the concept of Preventive Detention which, apart from being a colonial legacy, is also given explicitly in our constitution as 'the necessary evil' and laws exist under Article 22 of the Indian Constitution for the same reasons related to the security of the state and maintenance of public order. According to the provisions of section 10, the stipulated period of detention is 1 to 2 years.
2. **The Benami Transactions (Prohibition) Act, 1988 -** A Benami transaction is a transaction in which property is transferred to one person for a value paid or provided by another person and often, the identity of the persons involved is concealed. This Act was passed in 1988.

3. **The Indian Penal Code, 1860 and Code of Criminal Procedure, 1973 -** The Indian Penal Code, 1860 is the primary substantive law that regulates a number of criminal activities and also prescribes penalties for them. The Code of Criminal Procedure, 1973 on the other hand is a part of procedural law that specifies procedures to be followed in criminal cases.
4. **The Narcotic Drugs and Psychotropic Substances Act, 1985 -** This Act was passed in 1985 with the aim of consolidation and amendment of laws relating to narcotic drugs. Keeping in line with its objectives identifies, lists, and explains several forms and types of narcotic drugs and psychotropic substances.

3.9 PMLA REGULATIONS IN INDIA

To address the evolving landscape of crime and safeguard the nation's financial system, India has instituted a comprehensive framework of money laundering regulations, PMLA 2002, and subsequent amendments, serve against the illicit flow of funds and the manipulation of financial institutions for criminal gains. Some of the more significant regulations are as follows:

- **PML (Maintenance of Records) Rules, 2005 -** This legislation requires reporting entities to maintain records of transactions, provide suspicious transaction reports to the FIU-IND, and maintain CDD records.
- **PML (Amendment) Act, 2009**: The amendment was meant to strengthen the anti-money laundering framework by broadening the scope. It introduces the concept of "corresponding law enforcement agencies," allowing the sharing of information with foreign agencies.
- **PML (Amendment) Act, 2012**: The objective of this amendment is to further strengthen the AML framework by clarifying and enhancing provisions.
- **PML (Amendment) Act, 2015**: This amendment was made to align Indian AML laws with international standards. Thus bridging gaps, and enhancing transparency by introducing the concepts of "reporting financial institution" and "reporting authority"

- **PML (Maintenance of Records) Amendment Rules, 2023**: In March of 2023, the amendment's aim was to widen the scope of reporting entities and bolster customer due diligence requirements, bolstering AML compliance efforts. This revision mandates reporting entities to disclose beneficial owners and imposes stricter KYC norms for professionals like chartered accountants and company secretaries. This amendment also serves as a landmark because it extends AML measures to include cryptocurrency and virtual digital asset transaction.

3.10 KNOW YOUR CUSTOMER (KYC) CHECKS

Know Your Customer (KYC) checks are an essential component of AML regulations, requiring financial institutions to verify the identity of their customers and assess their risk of involvement in money laundering. This can include collecting basic information such as name, date of birth, and government-issued identification, as well as conducting more in-depth customer due diligence (CDD) and extended due diligence (EDD) for higher-risk clients. By conducting thorough KYC checks, financial institutions can better identify and report suspicious activities, helping to prevent money laundering and protect their customers from the negative impacts of illicit funds.

3.11 STRATEGIES TO PREVENT MONEY LAUNDERING

There are several strategies businesses can employ to prevent money laundering, ranging from implementing robust AML policies and procedures to monitoring transactions and providing employee training and awareness. By taking a proactive approach to money laundering prevention, businesses can not only protect themselves from the financial and reputational risks associated with this crime but also contribute to the global effort to combat financial crime and maintain the integrity of the financial system. The following sections will delve deeper into these strategies and discuss their role in inhibiting money laundering:

1. **Implementing Strong AML Policies** - Implementing strong AML policies is a crucial step in preventing money laundering. These policies should be adapted to the specific risks and vulnerabilities of the business and should include clear guidelines for detecting and reporting suspicious activities. By establishing a strong AML policy, businesses can:
    - Demonstrate their commitment to combating financial crime
    - Reduce the risk of fines and reputational damage.
2. **Monitoring Transactions** – It is another strategy for preventing money laundering. By closely monitoring customer transactions and analyzing patterns of activity, businesses can identify unusual or suspicious transactions that may be indicative of money laundering. This includes:
    - large or frequent cash deposits
    - wire transfers to or from high-risk jurisdictions
    - other transactions that deviate from the customer's normal pattern of behavior

Employee Training and Awareness**-** Employee training and awareness programs play an important role in preventing money laundering by ensuring that staff members understand their responsibilities and are equipped to identify red flags. By promoting a workplace environment where awareness and vigilance are prioritized, businesses can enable their employees to actively participate in the detection and prevention of money laundering. This can include providing training on:

- The various stages of money laundering
- The methods and techniques used by criminals
- The specific risks and vulnerabilities associated with the business or industry

3.12 AML COMPLIANCE

AML compliance is a fundamental requirement for regulated entities, such as banks, financial and money service businesses. Using effective AML policies and procedures, training and technologies helps the organization meet compliance requirements

AML compliance involves implementing policies and procedures to detect, prevent, and report money laundering activities like:

- Establishing a clear AML policy
- Designating a compliance officer to oversee the program
- Implementing tools and processes to detect and report suspicious transactions

By adhering to AML regulations, businesses can:

- Reduce their risk of regulatory fines and reputational damage
- Contribute to the fight against financial crime
- Create a more transparent and trustworthy financial system
- Benefit businesses, individuals, and society as a whole.

The amount of money laundered globally in one year is believed to be 2% to 5% of global GDP, or $800 billion to $2 trillion - and this is a low estimate. Money laundering is frequently associated with illegal arms sales, smuggling, embezzlement, insider trading, bribery, and computer fraud schemes. It's also widespread in organized crime, such as human trafficking, weapons or drug trafficking, and prostitution rings.

3.13 SUMMARY

Money Laundering is a universal menace and cannot be resolved by a single nation alone. The activities related to money laundering have been spreading in the Indian society, despite the best efforts of the Indian government to stop such practices. Through legislation and administrative bodies and efficient regulators who work tirelessly in this matter, the fight against money laundering activities continues to go on.

The evolution of AML regulations in India reflects the nation's determination to protect the country's economy. From the establishment of the PMLA to the inclusion of various timely amendments, India's efforts to safeguard its financial system have been admirable. Various steps and strategies have been followed to prevent money laundering. Amendments have also been made in this direction to curb the activities of money laundering. AML compliance stands as a solution for all these problems. KYC is another means to solve the problem.

3.14 KEY WORDS

1. **Money Laundering -** Money laundering can be understood as the process of transforming illegally obtained funds into seemingly authentic assets, making it difficult to trace the true source of the funds and use them for criminal activities. Money laundering is a crime that conceals the origins of illegally obtained funds, making them appear valid.
2. **Anti-Money Laundering** - Anti-Money Laundering (AML) refers to the activities financial institutions accomplish to achieve compliance with legal requirements to actively monitor for and report suspicious activities. AML refers to legally recognized rules for preventing money laundering.
3. **Placement**– It is movement of funds from direct association with the crime. The placement stage marks the beginning of the money laundering process where dirty money is introduced into the financial system. This stage is considered the most vulnerable for criminals, as they must find ways to deposit large amounts of cash without raising suspicion.
4. **Layering** - Layering is the second stage of the money laundering stages in which criminals engage in a series of transactions to create confusion and distance the funds from their criminal origin.

3.15 SELF-ASSESSMENT QUESTIONS

Long question answers

1. What is money laundering? What are its three stages?
2. What the common techniques of money laundering?
3. Explain various strategies of preventing money laundering?

Short question answers

1. Briefly explain the role of AML regulations in India.
2. Explain about AML compliance
3. What is the role of AML regulations in India?
4. What is KYC?

3.16 SUGGESTED READINGS

1. Law on Prevention of money laundering in India : M.C.Mehanathan
2. Money Laundering : prevention, Law and Practice : Abhijeet Sharma
3. Anit-Money laundering & Know Your Customer : Indian Institute of Banking & Finance
4. Money Laundering Law manual : Taxmann
5. PMLA : CA Kamal Garg

Dr.M.Syamala

LESSON – 4
FINANCIAL LITERACY

Aims and Objectives:

After reading this lesson the student would know the following aims and objectives:

- To understand what is financial literacy.
- To understand the importance and need of financial literacy
- To know how to manage financial issues and take good decisions.
- To understand the benefits of financial literacy.

Structure

4.1 Introduction
4.2 Financial Literacy
4.3 Pillars of Financial Literacy
4.4 Importance of Financial Literacy
4.5 Benefits of Financial Literacy
4.6 Strategies to Improve Financial Literacy Skills
4.7 Challenges and Solutions for Financial Literacy
4.8 Summary
4.9 Key Words
4.10 Self-Assessment Questions
4.11 Suggested Readings

4.1 INTRODUCTION

Financial literacy is the ability to understand and effectively use various financial skills, like personal financial management, budgeting, and investing. When a person is financially literate, he or she has the basic vital foundation of a nifty relationship with money. By finally literate the person can have a planned life without much money problem in the life. The term "financial literacy" refers to a variety of important financial skills and concepts. Educating on these topics also involves learning how money works, setting and achieving financial goals, becoming aware of unethical/discriminatory financial practices, and managing financial challenges that life offers.

4.2 FINANCIAL LITERACY

Financial literacy is the ability to understand and make use of a variety of financial skills including personal financial management, budgeting, and investing. It also means comprehending certain financial principles and concepts, such as the time value of money, compound interest, managing debt, and financial planning. Achieving financial literacy can help individuals to avoid making poor financial decisions. It can help them become self-sufficient and achieve financial stability. Those with higher levels of financial literacy normally spend less income and create an emergency fund which would help their retired life. Some of the basics of financial literacy and its practical application in everyday life include banking, budgeting, handling debt and credit, and investing. Key steps to attaining financial literacy include learning how to create a budget, track spending, pay off debt, and plan for retirement. Financial knowledge has close links with financial literacy or

financial education. Financial knowledge channeled and can be understood through financial education or financial literacy.

According to Lusardi financial literacy can be defined as financial knowledge with the aim of achieving prosperity. It can be understood that preparations should be made to meet the globalization, more specifically in the field of financial globalization issues.

According to Houston financial literacy occurs when an individual has a set of skills and abilities that make the person is able to utilize the existing resources to achieve the expected goals.

According to the World Bank definition, it is the internal capacity to act in one's best financial interest, given socioeconomic and environmental conditions. Jumpstart study (Mandell, 2008) defined financial literacy as the ability to use the knowledge and skills to manage financial resources effectively to improve welfare in the future.

According to Mason and Wilson, a financial literacy is a "meaning - making process" in which individuals use a combination of skills, resources, and contextual knowledge to process information and make-decisions with knowledge of the financials consequences of that decision.

From the definition given above, it can be concluded that financial literacy is an individual decision making that uses a combination of several skills, resources, and contextual knowledge to process information and make decisions based on the financial risk of the decision.

The Basic Personal Finance includes various basic understanding of a person in a financial system such as the calculation of simple interest, compound interest, inflation, opportunity cost, time value, asset liquidity, and others. Financial literacy is about spending and credit is how one can manage the spending. Financial literacy is a basic need for everyone to avoid financial problems.

Rashid viewed that financial literacy occurs when an individual is literate and has a set of skills and abilities that make the person able to utilize existing resources to achieve the goal. Financial literacy is defined as a person's ability to acquire, understand and evaluate information relevant to decision making by understanding the financial consequences thereof. The important thing to note here is that financial literacy only makes a person capable of making decisions based on relevant information. Financial literacy does not guarantee that the right decisions can be made.

To sum up, financial literacy is the knowledge of how to make smart decisions with money. This includes preparing a budget, knowing how much to save, deciding favorable loan terms, understanding impacts to credit, and distinguishing different vehicles used for retirement. These skills help individuals make smarter decisions and act more responsibly with their personal finances.

4.3 PILLARS OF FINANCIAL LITERACY

Financial literacy is having a basic grasp of money matters and its four fundamental pillars namely - debt, budgeting, saving, and investing. It is concern about how to build wealth throughout one's life by leveraging the power of these pillars. In simple terms, financial literacy is the difference between living from pay check to pay check, and being able to afford the things needed for earning wealth. The four pillars of financial literacy are discussed below:

1. **Debt:** Debt is money that an individual spends but it does not belong to that person. If money is borrowed from the bank, by using a credit card, or a short-term loan, or

a payday loan, then debt is accumulated by the individual who borrowed money from the bank. While debt is viewed negatively, for most people, it is necessary because only the extraordinarily wealthy can afford to pay for a house, car, or education with cash.

There are two types of debt – good debt and bad debt. It is necessary to understand the difference between good debt and bad debt and how to avoid bad debt as far as possible**.** Good debt is considered money borrowed for things that are absolutely necessary for making a life. Taking loan for construction of a house or for education can be considered as good loan

Bad debt is considered borrowing money or using a credit card to pay for things which is not really needed, such as expensive clothes, hi-tech electronics, eating out at restaurants, going on holidays, etc.

2. **Saving:** Saving is an essential part of financial wellness, a secure present, and a happy future. Wealth is built through spending less from income so that the following can be achieved:

- Realize important goals, whether it's to send for kids' education, fully paying off the loan on your home, or enjoying retirement.
- Establish an emergency fund to cope with life's curveballs, such as home or car repairs, illness, or unemployment. This should be about three to five months' worth of income.
- Enjoyment and pleasure trips to relax, such as an overseas holiday or a new sound system.
- Build an emergency fund to meet any unexpected financial challenges.

Saving would mean to keep an amount into an interest-yielding bank account not only keep money safely but also allow it to o grow it over time.

3. **Budgeting:** Budgeting is the life skill of planning and managing your money. By understanding exactly where how money is spent every month, you are empowered to create an actionable plan by which spending can be controlled. By curtailing those unnecessary expenses and saving more for the things can be materialized. The important concept here is that the income should be always greater than the expenditure. The difference between the two values is savings. But if the expenditure is greater than the income then definitely there is no scope of saving.

Budgeting helps to plan for short, medium, and long-term expenses, enabling to save accordingly. It is, therefore, entirely necessary for financial security and independence to plan the budget in favourable manner.

4. **Investing:** Investing is all about creating and growing the wealth needed for enjoying a financially secure and happy future. It's about putting money into something that will make a profit over time, such as property, retirement funds, and unit trusts.

The growth of investment can create a second, monthly income for and if it is sold out more money can be made than the originally invested. The funds generated by investments can then be used to meet the financial needs now and when needed. One must educate oneself wisely to invest in proper areas. Work toward diversifying portfolio to minimize the risk of investment and maximize potential returns.

5. **Earnings:** It is the heart of financial literacy. It's all above developing skills, pursuing education and securing a decent employment that can generate a standard income. By increasing the potentiality to earn opens doors for financial stability and individual

growth. Income is the foundation of financial stability and security. In order to have good earning the following strategies may be adopted:

- **Develop Diversified skills:** In today's fast growing and ever-changing market, it is necessary to have diverse skills. It is necessary to invest on learning new skills and expanding experience.
- **Negotiate as per ones worth:** One should not be shy in negotiating the rates or salary. Negotiating effectively can significantly boost the income level over time.
- **Side hustles:** With the development of new technologies the possibilities of side hustles are endless. It can be an online tutoring, starting a business or freelance work, etc., a side hustle can supplement the income and accelerate the financial progress of the individual.

6. **Protection:** It is necessary to safeguard and achieve monetary security as human life is full of uncertainties. By safeguarding financial well-being through proper protection measure one can lead a secured life. This can be possible through
    - **Insurance -** It is necessary to life insurance for health, life, accident etc. This would help to protect not only oneself but also the near and dear ones from unforeseen losses.
    - **Planning –** It is necessary to have a plan that can ensure assets and minimize potential conflicts,
    - **Protective measures -** It is necessary to protect and safeguard the personal and financial information. It can be done by using strong passwords, regularly monitoring one's own accounts and being cautious about sharing sensitive data online.
7. **Spending:** Individual's spending habits play a significant role in knowing the financial background of anyone. Being mindful and purposeful about spending can lead to a greater financial freedom. Spending should be:
    - Spending should be basing on need and wants. Genuine need should be taken care. By spending on necessary things one can become more conscious in wise in while taking decisions regarding financial matters.
    - Priority should be given both to quality and quantity of items to be purchased. Investment should be made in quality items with long term value, even if they have higher price. This actual saves more money in the long run.
    - Every individual should track spending. It is necessary to track the expenses made. This would help identifying spending patterns and make necessary adjustments wherever needed. It also helps to allocate more funds towards necessary financial goals.

4.4 IMPORTANCE OF FINANCIAL LITERACY

A study states that people with higher levels of financial literacy were more likely to make ends meet, spend less of their income, create a three-month emergency fund, and open a retirement account than those with lower financial literacy. Making informed financial decisions is more important than ever. Take retirement planning. Many workers once relied on pension plans to fund their retirement lives, with the financial burden and decision-making for pension funds borne by the companies or governments that sponsored them.

Now, only few get pension and other retirement benefits. Many have to plan their retirement life. They have to make extra contribution and take wise decisions themselves to secure their future. This involves decisions that employees themselves have to make about contribution levels and investment choices. Those without employer options need to actively seek out and open accounts for retirement and tax advantage.

Further they have to take care of social security benefits also. As on now due to various reasons people's increasing life spans and retirement age has increased the need for more and more need for security and social benefits. To meet these needs that barely support basic survival, complicated health and other insurance options, more complex savings and investment instruments to select from—and a plethora of choices from banks, credit unions, brokerage firms, credit card companies, and more people have to take correct financial decision and this is possible only when they are financially literate.

So. It is clear that financial literacy is a must for making thoughtful and informed decisions, avoiding unnecessary levels of debt, helping family members through these complex decisions, and having adequate income in retirement. Some of the advantages or importance of financially literate are listed below:

- People who are financially literate are generally less vulnerable to financial fraud.
- A strong foundation of financial literacy can help support various life goals, such as saving for education or retirement, using debt responsibly, and running a business.
- Key aspects to financial literacy include knowing how to create a budget, plan for retirement, manage debt, and track personal spending.
- Given the importance of finance in modern society, lacking financial literacy can be very damaging to an individual's long-term financial success.
- Can lead to a number of pitfalls, such as being more likely to accumulate unsustainable debt burdens, either through poor spending decisions or a lack of long-term preparation. This, in turn, can lead to poor credit, bankruptcy, housing foreclosure, and other negative consequences.
- Financial literacy can help protect individuals from becoming victims of financial fraud.
- Financial literacy is crucial for managing day-to-day expenses to long-term budget forecasting.
- It helps to plan and save enough to provide adequate income in retirement.
- It while in avoiding high levels of debt that might result in bankruptcy, defaults, and foreclosures.
- Financial literacy can be obtained through reading books, listening to podcasts, subscribing to financial content, or talking to a financial professional.

Although many skills might fall under financial literacy, main concepts include household budgeting, learning how to manage and pay off debts, and evaluating the tradeoffs between different credit and investment products. These skills often require at least a working knowledge of key financial concepts.

Other concepts like, mortgages, student loans, health insurance, and self-directed investment accounts, have also grown in importance. Financial literacy can cover short-term financial strategy as well as long-term financial strategy. Financial literacy encompasses knowing how investment decisions made today will impact your tax liabilities in the future. By improving financial knowledge, one becomes more confident about planning every

matter of money and finance matters. They don't become victims of any kind of financial frauds or scams.

4.5 BENEFITS OF FINANCIAL LITERACY

Holistically, the benefit of financial literacy is to empower individuals to make smarter decisions regarding money matters. Being financially literate is a skill that brings forth an assortment of benefits that can improve the standard of living for individuals through an increase in financial stability. Financial literacy is beneficial for the following reasons:

1. **Financial literacy helps to avoid stressful blunders**: Financial literacy helps individuals avoid making mistakes with their personal finances. For example, if an individual has taken a loan, it can be floating rate loans which have different interest rates each month. If the individual does not have idea in this matter wrong financial decisions may be taken. Therefore, one must be financially literate.
2. **Financial literacy prepares people for emergencies**: Financial literacy helps people to face emergencies. Emergency can be of any time like – loss of job, unexpected expenses etc. An individual can cushion the blow by implementing their financial literacy in advance by being ready for emergencies.
3. **Financial literacy can help individuals to reach their goals**: By better understanding how to budget and save money, individuals can create plans that set expectations, hold them accountable to their finances, and set a course for achieving seemingly unachievable goals. Making steps to becoming financially literate is an important component of life that can ensure financial solidity, reduce anxiety, and stimulate the achievement of financial goals.
4. **Financial literacy raises confidence in individuals**: To take financial decisions in life it is necessary to have knowledge in those areas, so that best decisions can be taken. By being armed with the appropriate knowledge about finances, individuals can approach with greater confidence and are less likely to be surprised or negatively impacted by unforeseen outcomes.
5. **Financial literacy helps to make better financial decisions –** Wise decisions can be taken if the individual has financial knowledge. The individual will not fall into financial frauds or be cheated. Decisions like how and where to invest will be taken in a wiser manner.
6. **Effective management of money and debt –** Individuals will be in a position to manage their income and expenditure in a proper manner, by which they will not fall into debt traps.
7. **Reduction of expenses through better regulation-** Financial literacy help to regulate unnecessary expenses and spend the income in a useful manner. It helps to curtail needless expenditure and spent the income on useful manner.
8. **Increase in ethical decision-making –** Through financial literacy individual can take better decisions on selecting insurance, loans, investments, and using a credit card. Ethical decisions regarding various financial matters can be taken in a better manner with assurance.
9. **Effective creation of a structured budget -** If the income is more than the expenditure then the individual will have surplus budget. But if the expenditure is more than the income, they the individual will face deficit budget. Managing budget is an art and should be planned very wisely or else the individual will fall pray to debts.

4.6 STRATEGIES TO IMPROVE FINANCIAL LITERACY SKILLS

Developing financial literacy to improve your personal finances involves learning and practicing a variety of skills related to budgeting, managing, and paying off debts, and understanding credit and investment products. Financially literate would mean having knowledge and confidence to manage financial matters effectively. This may include making budget, sticking on it, buying insurance, exploring investment and creating retirement savings plans etc.

The following are some of the tactics by which skills on financial literacy can be improved:

1. **Get knowledge on financial matters** - This can be done by reading financial books. Online resources are also plenty to enrich knowledge in this area. There are many best books for budgeting and savings, how to pay debts and advice for the first-time investors and strategies for building wealth etc. All these online and off line books can be of great help to enhance the knowledge on financial matters.
2. **Follow reputed financial newsletters-** Trusted newsletters can be of good help to know about financial matters. One can explore a large number of topic and gain insight into the current events and know various trends in personal finance. One can also follow smart strategies which are designed to help in financial journey to next level with insights on retirement planning.
3. **Use of social media –** According to 2023 Forbes Advisor survey 79 percent of individuals between the age group of 18 year and 41 years turn to social media for financial information. These include YouTube, Tok-tok, Facebook, link in etc. here one can get links to interesting articles and watch videos that discuss about various financial topics. This can help to improve the financial knowledge and build a better and secure future.
4. **Keep a budget –** It is essential to have a budget. It is necessary to track the income and expenditure. Budget would help to gain a better understanding as how the income is spent and how the money is allocated. This would help to analyze as where the need to tightened up the money and where there are opportunities for investing more money toward saving goals and better future.
5. **Talk or take advice from a financial professional -** A financial professional can be a good advocate and advice how and when to expand or contract the finance. They can answer all the financial queries, whether it is regarding basic day-to-day money situations or complex long-term investments.
6. **Use financial management tools -** Linking a financial management tool to personal account is a great way to improve financial literacy. There are popular apps that help to manage personal finances. They also provide access to financial literacy classes, tutorials and provide smart tips. Some apps tailored to needs and help to schedule payments and investments.
7. **Attend financial education camps** - The RBI has advised bank-operated Financial Literacy Centers (FLCs) to conduct special camps to address the dismal condition of financial literacy in India. These will be held until April 2018 at the very least and will touch base on some critical topics in financial literacy, viz.
    - KYC process while opening a bank account
    - Exercising credit discipline
    - Grievance redressal
    - And, Going Digital under UPI

Interactive methods such as posters and handouts in local languages, online quizzes, and face-to-face sessions will be used to increase participation and interest in financial literacy.

8. **Increase familiarity with own finances -** No amount of reading, lectures or apps are going to help if learnt knowledge is not put to practical use. The best way to try and implement the tips learned. Financial literacy depends on mindset and habits as much as theory; thus, it is imperative to make one's own budgets, manage debts and plan for the future. As they say, an ounce of practice is worth a ton of talk. Financial literacy helps you make balanced decisions. Being aware if basic financial tenets help avoid bad investments, high debt, and accumulate wealth.

RBI has also taken initiatives for Financial Literacy. Financial literacy is important for every individual, irrespective of age, gender, or economic condition. To improve the financial literacy levels, RBI has launched several programs and campaigns and created educational resources to financially empower individuals. Here is a list of initiatives RBI undertakes for financial literacy:

1. **National Centre for Financial Education (NCFE):** RBI established it in 2013. The Securities and Exchange Board of India (SEBI), the Insurance Regulatory and Development Authority of India (IRDAI), and the Pension Fund Regulatory and Development Authority (PFRDA), NCFE promotes financial education through workshops, seminars, training programs, and campaigns. It collaborates with regulators to develop a national strategy for financial education (NSFE). As part of its NSFE 2022-25 program, it emphasizes the '5 C' approach: content, capacity, community-led model, communication, and collaboration, targeting teachers, students, and others.
2. **Financial Literacy Centers (FLCs):** This initiative is to reach out to people at the district level. Under this, commercial banks create their FLCs in districts, especially rural areas, and conduct monthly camps to raise awareness about financial products among farmers, school children, senior citizens, self-help groups, and small and micro-entrepreneurs. Another objective is to lead community-driven financial literacy initiatives where it engages specific banks and NGOs at the block level to spread awareness at the grassroots level.
3. **'RBI Kahta Hai' Initiative:** This initiative educates people about banking facilities and services, including senior citizen banking, knowing banknotes, precautions in digital banking, Central Bank Digital Currency (CBDC), and other banking topics.
4. **Financial Education Microsite:** The RBI runs a microsite (https://www.rbi.org.in/FinancialEducation/) focused on spreading financial knowledge through films, games, and other resources in simple language. The information caters to schoolchildren, trainers, and entrepreneurs and is available in 13 languages, including Hindi and English.
5. **Financial Literacy Modules in School Curricula:** The RBI collaborated with several State Educational Boards in 2022 to introduce financial literacy modules in school curricula. Besides this, it conducts short-term campaigns like quizzes for school students, an annual financial literacy week with different themes to raise financial awareness, etc.

Thus, financial literacy is a life skill relevant to any age; it's about handling money better and inculcating responsible financial behaviour.

4.7 CHALLENGES AND SOLUTIONS FOR FINANCIAL LITERACY IN INDIA

The challenges people face in developing financial literacy include lack of financial knowledge, overconfidence about financial knowledge, lack of government initiatives, frameworks and regulations, lack of life-cycle planning, and ineffective methods of teaching financial literacy skills. Challenges faces are listed below:

1. **Lack of access to financial education –** Many individuals in India do not have access to financial education as such they are not financially literate. Financial education is not taught in schools or universities. As such the individuals are forced to rely on trial-and-error basis to learn about financial concepts.
2. **Intricate financial concepts -** financial concepts are normally difficult to understand, even for those individuals who have finance background.
3. **Financial frauds and scams –** Financial frauds and scams are prevalent and many individuals fall victims to them due to lack of financial literacy.
4. **Culture and societal norms -** Culture and societal norms can also be a major challenge to financial literacy. Some cultures may view discussing finances as taboo, which can be a hinder for an individual's ability to learn about financial concepts.
5. **Challenge of preparedness –** Many of the individuals are not ready to financial decision which have the element of risk. They are not prepared to make decisions in this aspect as there is a fear of losing the money.
6. **Challenge of confidence –** Many of the individual have overconfidence in many aspects of life. but when it comes to making crucial financial decision then there is a lack and lag. There are many reasons for this like lack of transparency regarding the financial institutions, no security, frauds and scams etc.

Improving financial literacy is vital to address the challenges faced by individuals and society. There are some ways to improve the financial literacy:

1. **Include financial education in schools and universities** – By incorporating financial education into the curriculum of students at schools and university level would help to develop financial literacy skill in them at an early age.
2. **Inducing simple financial concepts -** By simplifying financial concepts and teaching them to individuals would make the concepts easier and more attractive. It would make them easier to understand for individual with no background of finance.
3. **Encouraging individuals to seek financial advice -** Encouraging individuals to seek financial advice from experts can help them to make more confident and correct financial decisions. Experts can provide much better and right information in this regard.
4. **Educating individuals about financial frauds and scams –** This is one of the ways to bring awareness among the individuals. By educating them about the financial frauds and scams would help them to identify and avoid them.

4.8 SUMMARY

Financial literacy is the ability to understand and effectively use various financial skills, like personal financial management, budgeting, and investing. When a person is financially literate, he or she has the basic vital foundation of a nifty relationship with money. By finally literate the person can have a planned life without much money problem in the life. Financial literacy is a critical life skill that empowers individuals to make

informed financial decisions. It is also essential for businesses and the economy as a whole. However, many individuals and societies face challenges that hinder their ability to understand and manage personal finances effectively.

Including financial education into schools and universities, simplifying financial concepts, encouraging individuals to seek financial advice, and raising awareness about financial scams and fraud are some solutions to improve financial literacy. By addressing these challenges and implementing solutions, can improve financial literacy and promote economic growth in the country.

4.9 KEY WORDS

1. **Financial Literacy - Financial** literacy means having the knowledge and skills needed to make financial decisions, which will promote your financial stability and well-being.
2. **Budgeting -** Budgeting is the process of prioritizing your needs and obligations and assigning portions of your income toward those costs.
3. **Emergency Fund -** Emergency funds are cash reserves you set aside for financial emergencies or other unplanned expenses. They are typically equal to three to six months of your income or expenses.
4. **Income -** Income is all money you earn including wages, salaries, tips and other pay.
5. **Saving:** Saving is an essential part of financial wellness, a secure present, and a happy future.
6. **Investing:** Investing is all about creating and growing the wealth needed for enjoying a financially secure and happy future. It's about putting money into something that will make a profit over time, such as property, retirement funds, and unit trusts.

4.10 SELF-ASSESSMENT QUESTIONS

Essay Question answers

1. Explain the concept of financial literacy and elaborate the pillars.
2. What are the importance of financial literacy?
3. What are the strategies to improve financial literacy skills?
4. Briefly explain the challenges faced by individuals in financial literacy in India.

Short question answers

1. What are the pillars of financial literacy?
2. What are the solutions for financial literacy?
3. What are the benefits of financial literacy?

4.11 SUGGESTED READINGS

1. Financial literacy : Shaun M Durrant
2. Financial Literacy : Dr.Amit Kumar Singh
3. Simple path to wealth : JL Collins

Dr.M.Syamala

LESSON – 5

PROBLEMS AND CHALLENGES OF BANKING IN INDIA

Aims and Objectives:

- To understand the major challenges of banking in India.
- To understand the scenario of present banking sector.
- To know the methods to overcome these challenges of banking sector.

Structure

5.1 Introduction
5.2 Challenges faced by banking sector in India
5.3 Ways to overcome the challenges of banking sector
5.4 Opportunities in the Indian banking sector
5.5 Future of Indian banking
5.6 Summary
5.7 Key words
5.8 Self-Assessment Questions
5.9 Suggested Readings

5.1 INTRODUCTION

The banking industry faces various challenges, from regulatory changes to increasing competition. The problem is the situation and the challenge is the response. To face and solve these challenges, banks invest in technology solutions and explore new business models. By staying alert and adapting to changing market conditions, banks can remain competitive and efficiently meet the needs of their customers.

The Indian banking and financial system have come a long way since its early days. As of 2022, the total assets across all banking sectors (public and private banking) crossed $2.67 trillion. India has one of the world's largest retail banking and financial services institutions - with 12 public sector banks, 22 private banks, 46 foreign banks, 56 regional rural banks, 1485 urban cooperative banks, and 96000+ rural cooperative banks, along with other credit institutions. Government of India nationalized 14 banks under the Banking Regulation Act of 1949. In 1991 liberalization of the banking system in India pave way to private banking institutions like HDFC Bank, Axis Bank, ICICI Bank, DCB, and IndusInd Bank.

5.2 CHALLENGES FACED BY THE BANKING SECTOR IN INDIA

The challenges faced by banking sectors in India are discussed below:

1. **Regulatory Changes** – This is one of the biggest challenges facing by the banking sector in India. Banks must comply with various regulations, from anti-money laundering (AML) to data protection laws. To keep up with these changes can be an exhausting work and time-consuming as well as costly process, which can impact the profitability of banks. To address these challenges, many banks are investing in technology solutions to

automate regulatory compliance. These solutions can help banks stay up to date with regulatory changes and streamline compliance processes.

2. **Cybersecurity Risks-** As banks become more digital, they also become more vulnerable to cyber-attacks. Cybersecurity risks are a major concern for the banking industry now. To protect themselves from such attacks, banks must invest heavily in cybersecurity solutions to protect their customers' data and prevent fraud. Many banks are partnering with cybersecurity firms to develop more robust security measures. Banks are investing in employee training programs to help them identify and prevent cyber-attacks.

3. **Improve risk management system -** RBI had issued guidelines on asset liability management and Risk Management Systems in Banks in 1999 and Guidance Notes on Credit Risk Management and Market Risk Management in October 2002 and the Guidance note on Operational Risk Management in 2005. Banks in India are moving from the individual segment system to an enterprise-wide Risk Management System. Banks need to concentrate on allocating significant resources towards this objective over the next few years.

4. **Customer Expectations** - As consumers become more digitally savvy, their expectations for banking services are changing. Customers now expect seamless, personalized experiences across all channels, from mobile banking apps to online portals. To meet these expectations, banks are investing in digital solutions that provide customers with easy-to-use interfaces and personalized experiences.

5. **Increasing Competition** -The banking industry is facing increasing competition. These new digitalized banks are able to offer innovative products and services that traditional banks may struggle to provide. To compete with these new banks many are investing in their own digital solutions and partnering with fintech startups.

6. **Economic Uncertainty** - The global economy is facing increasing uncertainty, with factors such as political instability and trade tensions impacting economic growth. These uncertainties can impact the banking industry, as banks may face reduced demand for loans and other financial services that are major sources for banks to make money. To address these challenges, banks are taking steps to diversify their portfolios and reduce their exposure to risk.

7. **Fintech Disruption** - The rise of fintech companies is disrupting the traditional banking industry. Fintech companies are often able to offer faster, cheaper, and more innovative services than traditional banks. This is forcing banks to adapt and compete by investing in their own technology and partnering with fintech companies to offer new services.

8. **Talent Management** - Attracting and retaining top talent is a challenge for many banks. As the industry evolves, banks need employees with a wide range of skills, including technological expertise, regulatory compliance knowledge, and customer service skills. Banks must invest in training and development programs to help employees stay up-to-date on new technologies and regulations.

9. **Increasing competition** - The emergence of FinTech. startups have brought about a vast change in the competitive scene in financial services, forcing traditional firms to reconsider their way to do business.

10. **Rural Coverage** - Indian local banks especially state bank groups having a good coverage and many branches in rural areas. But that is quite lacking technical enhancement. The services available at cities are specifically not available to rural branches, which are necessary if banks want to compete now a day. This is one of the challenges faced by the banking system in India.

11. **Technological shift** - In this digital era there is no room for manual processing systems in banking industry. This technological shift towards a digitalized technology has put the banking system in a digital challenge. Their attitude has to be wide acceptances of digital transformation.

12. **Changing business models** - The cost associated with compliance management is one of the major challenges in the banking sector. The banking system has to change their way to doing business. These institutions have to create new competitive service and offer rationalize business and seek sustainable improvement in operational efficiency to maintain profitability.

13. **Customer services –** Any bank has to take care of its **c**ustomers. They have to maintain good relationships and fulfill their expectation. Further banks need to implement customer centric approach. Banks are expected to oblige to provide Banking services to all segments of the population, on equitable basis. Further, the consumers interests are at times not accorded full protection and their grievances are not properly attended to by Banks. Banks are expected to encourage greater degree of financial attachments in the country setting up of a mechanism for ensuring fair treatment of consumers; and effective redressed of customer grievances.

14. **Outdated Mobile experiences -** A bank's mobile experience needs to be fast, friendly to use, fully featured with all necessary and required characteristics further it should be secure and regularly updated in order to keep customers satisfied.

15. **Security cracks-** Security is one of the leading banking industry challenges as well as a major concern for bank and credit vision. Customers financial institutions must invest in the latest technology-driven security measures to keep sensitive customer safe. Ex- AVS (Address Verification Service) E2EE (End-to End Encryption, (E2EE) for secure communications, Biometric authentication, location-based authentication to prove an individual identify, RBA (Risk-based authentication) varying levels of stringency.

16. **Outdated application-** One of the major challenges in banking is that they use outdated applications and apps. Like AI offers a significant competitive advantage by providing deep insights into customer behaviour and needs giving ability to sell the right product at the right time to the right customer.

17. **Continuous Innovation:** Sustainable success in any business requires insight, agility, rich client relationships and continuous innovation. Cloud technology systems to evolve along with any business.

18. **Non- performing assets:** The rise of Non-Performing Assets (NPAs), including bad loans or problems in the agricultural and corporate sectors. Currently, the country's NPAs have crossed ₹5.24 trillion in 2022, with more than 70% being from the corporate sector.
    - The increasing number of frauds, including accounting fraud, demand draft fraud, uninsured deposits, fraudulent loans, and others. The RBI in 2022 reported total fraud cases of around 9103, the biggest being the PNB scam of ₹11,000 crores, Vijay Mallya defaulting lenders for Rs. 9000 crores, and several others that we have witnessed recently.
    - Lack of banking for the underserved and rural population, which is approximately 69% of India's total population. Around 1.4 billion Indians do not have access to formal banking, as per the World Bank report.
    - Lack of reach in rural areas, where technical enablement and use of financial services remain a big challenge.
    - As per the report of the Standing Committee on Finance who gave their report on August 31, 2018, the credit and deposit growth in banks have recently been slow. High volumes of non-performing assets (NPAs) in banks have eroded their capital base, and restricted their ability to lend. Key observations and recommendations of the Committee include:
    - The Committee noted that the problem of high loan write-offs and NPAs, combined with low asset growth, is more severe for public sector banks (PSBs) than private banks.
    - The Committee expressed concern about limited improvements in the short-term earnings of PSBs as a result of NPAs.

Apart from the above challenges there are few more :

1. Traditional banking habits

Many of the customers are not comfortable with the changing technologies in banking system. They prefer the tradition mode of banking. Such aversion to change is usually due to a lack of trust in the online system or the inability to operate online portals. As a result, banks are struggling to convince people to adopt online banking. In this case, banks can simply demonstrate the benefits and the drawbacks of traditional banking to their customers.

2. Security and fraud instances

Security and protection against fraud and hacking are some of the most significant problems for banks promoting online banking. In traditional banking, robbers would have to break into the bank to steal money from customers. However, skilled hackers can crack bank security measures to get customers detail and illicitly transfer money.

3. Cross-border transactions

In the past, cross-border payments have been slow, inefficient, and expensive. This is because most of the banks use traditional infrastructure. New technologies including blockchain have been promising in overcoming such drawbacks to facilitate smooth cross-border transactions. But many precautions have to be taken to deal such transactions.

4. Technical issues

Banks are heavily reliant on online platforms to perform operational tasks including cash transfers, transaction recording, and information storing. A single system crash or a bug in their code can cause millions of dollars in losses or can even cause the bank to shut down its operations temporarily. Similarly, customers can lose trust in online banking when it's not functional for that time. So, banks face challenges in not only running their online platforms smoothly but also look towards their mobile apps.

5. multi-currency and multi-payment methods

The rise of global e-commerce has created new problems. Consumers around the world use various payment methods like- credit card, debit card, PayPal, bank transfers, e-wallets, and mobile payments etc. In this process, they face difficulties with multi-currency, cross-border transactions, bank accounts, business entities, and regulatory hurdles.

6. Digital Transformation

The online banking sector grapples with the challenge of seamlessly integrating digital transformation initiatives with existing legacy systems. Transitioning from manual processes to digitized system requires substantial investments in technology and to overcome resistance from traditional banks with established business models.

7. Navigating Regulatory Landscape and Compliance

Financial institutions operating in the online banking sector must contend with a complex regulatory environment. Managing regulatory requirements, including those related to cryptocurrency and financial technology, adds complexity to the business models of traditional banks and smaller institutions alike. The pressure to comply with regulations while innovating and maintaining a competitive edge is a continuous challenge.

To gist up it would be right to say the during the post reform period and due to the situation of Liberalization, Privatization and Globalization, Indian banking sector is facing some problems and challenges. These are:

- Low Profitability and Productivity
- Lack of Integrity
- Increase of Administrative Expenses
- Survival of loss-making branches
- Scandals
- Lack of Professional Behavior
- Lack of professional and friendly approaches with customer
- Non-performing Assets
- Customer oriented market
- Problem of customer satisfaction
- Depression period running over the country
- Managing work force
- Management of technological advancement etc.

5.3 WAYS TO OVER COME THE CHALLENGES OF BANKING SECTOR

Overcoming the challenges of banking sector requires a multi-faceted approach that focuses on technology, security, customer experience, and regulatory compliance. Following are some of the ways and means to over come the challenges faced by the banking sector in India:

1. Enhance Cybersecurity

In the modern digital world cyber-attacks are more so the first priority should be security of customer data and transactions. Banks should invest in pioneering cybersecurity measures, including encryption, multi-factor authentication, and continuous monitoring to protect against cyber threats and data breaches. Banks should regularly go for security audits and employee training to maintain a strong defense.

2. Improve User Experience

It has become essential that banks should opt for a seamless and user-friendly interface to attract and retain customers. Online banks should invest in user friendly design, creating spontaneous and responsive digital platforms. Offering a variety of services, such as mobile banking apps, chatbots, and 24/7 customer support, ensures customers have a positive experience and many such other services.

3. Regulatory Compliance

Online banks must stay up-to-date regarding the changes and improvements in regulatory requirements, including data protection and anti-money laundering laws etc. By maintaining compliance, banks can build trust with customers and regulatory authorities, leading to sustained growth without much legal hindrances.

4. Digital Marketing and Education

Online banks should invest in digital marketing strategies to raise awareness and educate potential customers about the benefits and security of online banking. This includes promoting features like mobile check deposits, bill payment, and budgeting tools to showcase the convenience and advantages.

5. Anti-Money Laundering (AML)

Banks must have systems in place to detect and report suspicious activity related to money laundering. We have already discussed this topic in the previous chapter.

6. Know Your Customer (KYC)

Banks must verify the identity of their customers and maintain records of their information so that the transactions and bank activities can be done in fair and genuine manner.

7. Consumer Protection

Banks must comply with laws and regulations that protect consumers, such as the Truth in Lending Act and the Fair Credit Reporting Act.

8. Financial Reporting

Banks must file regular reports with regulatory agencies such as the Federal Reserve and the Office of the Comptroller of the Currency. Banks should follow all the regulations laid out by the central bank.

9. Capital Adequacy

Banks must maintain sufficient capital to meet regulatory requirements and protect against losses. This is one of the ways to solve the problems in the banking sector.

10. Stress Testing

Banks must conduct regular stress testing to evaluate their ability to withstand economic downturns and other adverse scenarios. This will help the banks to work in more efficiently and give better services to the customers.

5.4 OPPORTUNITIES IN THE INDIAN BANKING SECTOR

According to IBM's Report titled 'Banking on India,' India's banking systems are experiencing significant disturbance and change and have invested majorly to bank on technology transformations. Some of the important initiatives undertaken by the central government for financial enablement and digitization are proving to have fruitful results. As per the report, the following are some of the opportunities that India can unlock:

1. **Financial Inclusion:** 300 million individuals opened a bank account for the first time since the government initiative to provide accessible and affordable financial services to the masses, called the Pradhan Mantri Jan Dhan Yojana, in 2014. Since 2011, the unbanked population has been cut down to half. In addition, 55% of Jan Dhan account holders are women, and 67% of the account holders reside in rural and semi-urban areas.
2. **Digital Payments**: In 2016, the Government of India launched the UPI (Unified Payment Interface) System and BHIM, along with the National Payments Corporation of India (NPCI). This has improved mobile banking and online payments, creating a digital revolution.
3. **Rise of Neo Banking**: In 2021, the Niti Ayog proposed to set up 'digital banks,' which rely on the internet to offer their services instead of physical branches. This will revolutionize how banking as a service is provided to customers and create new opportunities for rural and urban sectors.

However, banks have some prospects in present environment. By converting threats into opportunities, the bank can have many advantages. The opportunities are: -

1. Offering of innovative products
2. Door to door service approach
3. Customer relationship management
4. Professional approaches
5. Managerial excellence
6. Marketing and technological advancement
7. Customized and cyber services
8. Branch expansion
9. Deposit Mobilization
10. NPA management
11. Asset reconstruction
12. Motivational HRM policies

13. Change in lending process
14. Merger and acquisition
15. Total quality management concept

5.5 FUTURE OF INDIAN BANKING

In the future, India's financial system will witness a greater emphasis on providing improved and personalized services to clients. In future, banking may cease to be a separate service. Instead banking sector would be embedded in all products and services which consumer except to avail from the banks. Embedded finance is the integration of financial services within the products or services of a non-financial organization. We can expect that in future a customer may not have to visit any bank to avail a loan. Technological solutions may allow the banks to offer prices that could be feasible and flexible to the needs of the customers.

This will be coupled with being able to match competitive rates through the introduction of Neo-banks and other digital lending options that are now available to the customers. The future would see robust growth driven by innovation and investment in infrastructure, digital enablement, and a focus on mobile and internet banking.

As per IBEF, India's fintech market is expected to reach ₹6.2 trillion in 2025. It will witness greater regulatory support, such as the advent of RBI's regulatory sandbox, which will allow fintech to test out their concepts and innovations before going live. Further, it estimated that it will work with more than 4200 fintech startups to create a more disruptive, accessible, and innovative future. This can catalyze major initiatives to enable India's financial services offerings to be more vigorous and fast-paced, including:

- The use of blockchain creates a more decentralized and safe process for banking processes.
- Banking institutions have already partnered with blockchain firms to allow customers to get cross-border remittances via Ripple, and there could be more implementations underway.
- Personalized banking system would be provided use of Artificial Intelligence systems for chatbots, fraud detection, risk management, investment, and other banking processes.
- Increase in peer-to-peer lending, which would be safer and less risky while enabling an option for customers with low financial requirements to benefit from these platforms.
- Banks would encourage mobile banking and contactless payments in the near future.
- A paper less banking system would emerge.

5.6 SUMMARY

Indian banks are trust worthy brands in Indian market, therefore these banks must utilize their brands equity as it is a valuable asset for them. Various challenges and opportunities like transparency, growth in banking sector global banking, managing technology etc. Banks have to strive very hard to deal with competition. The competition from global banks and technological innovation's all are the world compelled the banks to rethink their policies and strategies, finally the banking sector will need to master a new businessmodel by building management and best customer service.

India's banking systems are experiencing significant disturbance and change and have invested majorly to bank on technology transformations. The banking system is finding opportunities in the threats that it is facing. In the future, India's financial system will witness a greater emphasis on providing improved and personalized services to clients. In future, banking may cease to be a separate service. Instead banking sector would be embedded in all products and services which consumer except to avail from the banks. Embedded finance is the integration of financial services within the products or services of a non-financial organization. We can expect that in future a customer may not have to visit any bank to avail a loan. Technological solutions may allow the banks to offer prices that could be feasible and flexible to the needs of the customers.

5.7 KEY WORDS

1. **Fintech Disruption** - The rise of fintech companies is disrupting the traditional banking industry. Fintech companies are often able to offer faster, cheaper, and more innovative services than traditional banks.

2. **Security cracks-** Security is one of the leading banking industry challenges as well as a major concern for bank and credit vision. Customers financial institutions must invest in the latest technology-driven security measures to keep sensitive customer safe. Ex- AVS (Address Verification Service) E2EE (End-to End Encryption, (E2EE) for secure communications, Biometric authentication, location-based authentication to prove an individual identify, RBA (Risk-based authentication) varying levels of stringency

3. **Non- performing assets:** The rise of Non-Performing Assets (NPAs), including bad loans or problems in the agricultural and corporate sectors. Currently, the country's NPAs have crossed ₹5.24 trillion in 2022, with more than 70% being from the corporate sector.

4. **multi-currency and multi-payment methods -** The rise of global e-commerce has created new problems. Consumers around the world use various payment methods like-credit card, debit card, PayPal, bank transfers, e-wallets, and mobile payments etc. In this process, they face difficulties with multi-currency, cross-border transactions, bank accounts, business entities, and regulatory hurdles.

5. **Know Your Customer (KYC) -** Banks must verify the identity of their customers and maintain records of their information so that the transactions and bank activities can be done in fair and genuine manner.

6. **Neo Banking**: In 2021, the Niti Ayog proposed to set up 'digital banks,' which rely on the internet to offer their services instead of physical branches. This will revolutionize how banking as a service is provided to customers and create new opportunities for rural and urban sectors.

5.8 SELF-ASSESSMENT QUESTIONS

ESSAY TYPE QUESTIONS

1. What are the challenges faced in the Indian Banking system?
2. What are the ways to overcome the challenges of banking sector?

3. What are the opportunities in the Indian banking sector?
4. Write a note on the future of Indian banking system.

SHORT TYPE QUESTIONS

1. How can the banking sector in India convert the threats into opportunities?
2. Briefly explain the problems in the Indian banking sector.
3. Elucidate the future of Indian banking system.

5.9 SUGGESTED READINGS

1. Levesque, T. and Mcdougall, 1996. "Determinants of customer satisfaction in retail banking", International Journal of Bank Marketing, pp.12-20.
2. Uppal, R.K. 2007, "Banking services and IT" New century publications, New Delhi.
3. Anatolig G. Goncharuk (2012) “Banking Sector challenges in Research”
4. Dr. Krishna A. Goyal and Vijay Joshi (2014) “Indian Banking Industry: Challenges and Opportunities. International Journal of Business Research &Management, vol.3Issue1,18-28.
5. Dr. Lakshmi Bhai P.s. (2018) “E-banking in India – problems & prospects. International journal of Current Engineering and Scientific Research. Vol.5 Issue 1
6. Dr.K. Ratna Manikyam (2014) Indian Banking Sector – Challenges &Opportunities. International Journal Of Business & Management Vol.16 Issue 2,52-61. Niti Bhasin, 2007, "Banking development in India 1947 to 2007", Century publication, Delhi 110005.
7. Mithani, D. M. 2004. Money, Banking and Public Finance. First Edition, Himalaya Publishing House, Mumbai, p. 113.
8. Goyal, K.A. and Joshi, V. 2011. "Mergers in banking industry of India: some emerging issues", Asian journal of business and management sciences, pp.157-165.

Dr.M.Syamala

LESSON - 6
BANK DEPOSITS

Aims and Objectives:

After reading this lesson the student would know:

- The various types of bank deposits.
- To open savings, current, and salary accounts.
- To open fixed and recurring deposit accounts.
- To understand the formalities to be complied for opening a bank account
- To know how to withdraw sums easily from all accounts.
- To know the circumstances under which a bank account is to be closed

STRUCTURE

6.1. **Introduction**
6.2. **Types Of Bank Accounts**
6.3. **Opening Savings Bank Account**
6.4. **Opening Current Account**
6.5. **Opening Fixed Deposit Account and Recurring Deposit**
6.6. **Steps In Opening Accounts**
6.7. **Customer Identification**
6.8. **KYC Documents for Normal Customers**
6.9. **Closing Of Bank Accounts**
6.10. **Summary**
6.11 **Key Words**
6.12. **Self-Assessment Questions**
6.13. **Suggestive Readings**

6.1. INTRODUCTION

Primarily, banks offer two kinds of deposit accounts. These are demand deposits like current/saving account and term deposits like fixed or recurring deposits. When you open a deposit account in a bank, you become an account holder or a depositor. Saving accounts are used to meet daily on-demand requirements of cash. For example, you hold a saving bank account with the bank having cheque book facility. The bank asks you to maintain a minimum balance of Rs 1000. In return, the bank pays you an interest at the rate of 4% per annum. You may operate the saving account using an ATM card also. Banks impose limits on the frequency and amount of withdrawal using ATMs. The deposit rates on saving account keeps changing based on RBI's revision of policy rates. Banks offer lower interest rates on saving account as compared to term deposits. It is because of this reason; investors opt for term deposit accounts. A term deposit account is used to hold money for a fixed period of time. In return for this, the bank pays interest on the term deposits. However, you are not allowed to withdraw your money before expiry of the fixed duration. For example, you hold a fixed deposit (FD) of Rs 10,000 for a period of five years with the bank. In return, the bank pays you an interest at the rate of 10% per annum.

Bank deposits consist of money placed into banking institutions for safekeeping. These deposits are made to deposit accounts such as savings accounts, checking accounts, and money market accounts at financial institutions. The account holder has the right to withdraw deposited funds, as set forth in the terms and conditions governing the account agreement.

Bank deposits are a savings product that customers can use to hold an amount of money at a bank for a specified length of time. In return, the financial institution will pay the customer the relevant amount of interest, based on how much they choose to deposit and for how long. Once the agreed term has elapsed, the bank will return the amount deposited plus the interest to have accrued over that period at the agreed rate. Bank deposits are considered one of the safest savings products. There is a specific structure, known as the Deposit Guarantee Fund**,** which guarantee up to €100,000 for each account holder and bank at which a deposit is held. Being a very safe savings product, bank deposits offer somewhat lower returns than what we might expect to obtain from equity or fixed-income products, which come with higher risk.

A bank account is a financial arrangement between an individual or a business and a banking institution. This relationship facilitates the secure storage of money, easy access to funds, and the facilitation of transactions. It is a primary tool for managing personal finance, providing a mechanism for receiving income, saving for the future, and making payments for goods and services. They are essential in our current economic climate, enabling efficient financial management, facilitating activities like online shopping, automating bill payments, and paving the way for credit history establishment, which is vital when seeking loans or credit cards. Financial institutions offer various bank account types tailored to diverse needs, including accounts for daily transactions, savings, or investing, and understanding these can help in selecting the best fit for one's requirements.

6.2. TYPES OF BANK ACCOUNTS:

Bank accounts are divided in the given below:

1. **CURRENT OR DEMAND DEPOSIT ACCOUNT:** A current account, also called a demand deposit account, is a basic checking account. Consumers deposit money and the deposited money can be withdrawn as the account holder desires on demand. These accounts often allow the account holder to withdraw funds using bank cards, checks, or over-the-counter withdrawal slips. In some cases, banks charge monthly fees for current accounts, but they may waive the fee if the account holder meets other requirements such as setting up direct deposit or making a certain number of monthly transfers to a savings account. There are several different types of deposit accounts including current accounts, savings accounts, call deposit accounts, money market accounts, and certificates of deposit (CDs).

2. **SAVING ACCOUNT:** Savings accounts offer account holders interest on their deposits; however, in some cases, account holders may incur a monthly fee if they do not maintain a set balance or a certain number of deposits. Although savings accounts are not linked to paper checks or cards like current accounts, their funds are relatively easy for account holders to access. In contrast, a money market account offers slightly higher interest rates than a savings account, but account holders face

more limitations on the number of checks or transfers they can make from money market accounts.

3. **CALL DEPOSIT ACCOUNTS:** Financial institutions refer to these accounts as interest-bearing checking accounts, Checking Plus, or Advantage Accounts. These accounts combine the features of checking and savings accounts, allowing consumers to easily access their money but also earn interest on their deposits.

4. **CERTIFICATES OF DEPOSITS OR TIME DEPOSIT ACCOUNTS:** Like a savings account, a time deposit account is an investment vehicle for consumers. Also known as certificates of deposit (CD), time deposit accounts tend to offer a higher rate of return than traditional savings accounts, but the money must stay in the account for a set period of time. In other countries, time deposit accounts feature alternative names such as term deposits, fixed-term accounts, and savings bonds.

5. **SALARY ACCOUNTS:** Although a Salary Account is also a type of Saving Account, it stands apart as your employer opens it for you for the sole purpose of depositing your remuneration. Unlike most accounts, where you can choose your preferred bank, you do not get to choose your preferred bank for your Salary Account. Companies usually tie up with one specific bank to open Salary Accounts for their employers. You can withdraw every last rupee deposited by your employer in this account, which is why a Salary Account is also known as a zero-balance account.

6. **FIXED DEPOSIT ACCOUNTS:** A Fixed Deposit is a type of deposit that is ideal for conservative investors. A Fixed Deposit account is one where you deposit or put away a sum of money for a specific tenure with the bank. You earn interest on the fixed amount for the term of the deposit. You can choose to open a cumulative fixed deposit account to withdraw both the principal amount and the interest payment when the deposit matures. You may also opt to receive a fixed monthly or quarterly interest payout. With Fixed Deposit Accounts, you cannot withdraw money until maturity. If you choose to do so, you have to pay the penalty, a specific amount set by the bank.

7. **RECURRING DEPOSIT ACCOUNTS:** With Fixed Deposits, you generally put away a lump sum amount. On the other hand, a Recurring Deposit Account is one where you deposit a fixed sum of money at fixed and recurring intervals, usually on a monthly or quarterly basis. With Recurring deposits, you can put away a small amount each month to fulfil the greater goal of creating a lumpsum. Typically, you have to deposit the same fixed amount on the selected date for the entire investment tenure. RDs naturally come with maturity tenures ranging from 6 months to 10 years. Like FDs, if you decide to withdraw your Recurring Deposit Account prematurely, you have to pay a penalty through which the bank reduces the interest rates.

6.3. OPENING SAVINGS BANK ACCOUNT

Normally, a banker will not open an account in favour of a stranger. Any person who wishes to open a savings account has to be introduced by another savings account holder of the same branch. Even a minor is allowed to open a saving account.

6.4. OPENING CURRENT ACCOUNT

In the case of current account, it cannot be opened by any person unless he is introduced by another current account holder of the branch. The current account holder has to give a letter of introduction in favour of the person intending to open the current account. Current account can also be opened when the employee of the bank gives a letter of introduction about the person intending to open the current account. A third type of letter of introduction can be given by a well reputed person known to the banker. The contents of letter of introduction must spell out the conduct and character of the person intending to open the current account. It is more of a fidelity guarantee vouchsafing the character of the person, willing to open the current account. The banker requires such a letter as the current account holder is not only providing with overdraft and cash credit facility but also acceptance of third-party cheques through endorsement. At present the bank insists not only the introduction but also the photographs in duplicate of persons intending to open an account; one photograph is affixed in the pass book and the other in the ledger.

6.5. OPENING FIXED DEPOSIT ACCOUNT AND RECURRING DEPOSIT

For opening a fixed deposit account, the banker does not impose any condition. But he normally accepts fixed deposits from known persons and the fixed deposit account is opened only by deposit cash or in case of cheques only after realization of cheques. The same rule applies for recurring deposit also.

6.6. STEPS IN OPENING ACCOUNTS

Following are the steps involved in the opening of an account for customer, by a banker:

1. **OBTAINING LETTER OF INTRODUCTION -**The first and the foremost step in opening an account for a new customer is to obtain a letter of introduction from the person who wants to open an account. A letter obtained by a banker from a prospective customer before a banker can open an account in the name of the prospective customer is known as 'letter of introduction'. The purpose of obtaining this type of a letter enables the banker to ascertain the genuineness of applicant. The letter serves as a letter of guarantee of conduct and genuineness of the applicant obtaining a letter of introduction is an important duty of a modern banker. The information obtained so helps the banker in confidently providing various services of banking and financial services. The information is also need to obtain protection from the provisions of the various legislations that are in force from time to time as part of carrying out the banking business.

Benefits/purposes:

Obtaining a proper letter of introduction is beneficial for the banker to know more about the new customer in the following manner:

- Protecting against issuing cheque books to unscrupulous persons.
- Facilitating the claiming of overdraft inadvertently granted by the banker.
- Protecting against undischarged insolvent.
- Helping to provide correct financial information about the customer.
- Obtaining statutory protection

2. **APPLICATION FORM:** After obtaining a letter of introduction, the banker supplies an application form according to the type of account, which the customer wants to open The application form contains the rules and regulations of the bank with the terms and conditions of deposit. The application form is to be filled in and handed over to the banker. The applicant furnishes all details about himself including the name, nomination, address, etc,

3. **SPECIMEN SIGNATURE:** After the application form duly filled in, the banker obtains the specimen signature of the new customer in a separate card called 'specimen signature' card. Every customer is expected to have read the rules of business of the bank to confirm in writing his willingness to comply with and bound by them before his account is opened. He is required to supply his bankers with one or more specimens of his signature and the bank usually enters these in a signature card maintained for the purpose. The cards are filed and arranged in an alphabetical order. Each customer's name must be written in bold characters above his account in the ledger. His address and occupation are also noted.

4. **FIRST TRANSACTION:** After obtaining the specimen signature of the new customer, the banker opens the new account by obtaining cash from the new customer. This marks the first transaction between the new customer and the banker. The relationship between the banker and customer begins after this transaction.

5. **ISSUE OF CHEQUE, PAY-IN –SLIP, AND PASSBOOK:** The banker issues pay-in-slips, cheque book, and passbook immediately after successfully completing the first transaction with the customer. The cheque book supplied to the customer usually contains ten or twenty blank forms. These leaves are used for making payments. A cheque book contains a requisition slip which helps to get a new cheque book. Pay-in-slip or credit voucher are forms used to pay coins, notes, bills, and cheques to the credit of customer's account. Each slip should be signed by the customer or the person who has prepared it on his behalf. For correct accounting, name, account number, date, and the amount of the customer should be clearly mentioned. Customer will receive a duplicate slip or counterfoil with a signature and the rubber stamp of the banker. It is an acknowledgement to the customer that cash, etc,. have been duly received. The initials of the cashier in counterfoil do not in any way mean that the cheques, etc., are in order.

6. **PAY-IN-SLIP BOOK:** The pay-in-slip book is a book that contains printed slips with perforated counterfoils to be filled in by the depositor or his agent at the time of depositing cash, cheques, drafts, etc., to the credit of his account. Usually, every bank prescribes and supplies free of cost separate pay-in slips for depositing cash and cheques and drafts. The contents of pay-in–slips include the information regarding the date of deposit, name and account number of the customer, amount to be deposited, etc.

7. **DONATIO MORTIS CAUSA:** Donatio mortis causa means a gift made in contemplation of death. The gift is said to be made by a person who owns any movable property and who is very ill and believes that he is going to die. This is a peculiar gift as it has a condition that it will come into operation if only the donor actually dies of the illness. But if he recovers from the illness, the gift is to e returned.

8. **PRINTED CHEQUE FORMS- MERITS:** A cheque drawn on any paper is legally valid. In England, banks honour cheques even they are not drawn on forms supplied by them. However, when the customer draws a cheque on ordinary slip of paper, the banker must be careful to see that it is an unconditional order. Otherwise, the banker would lose the statutory protection. But it is to be noted that using plain papers to write cheques will prove risky for the paying banker. Hence, bankers always insist on using printed cheque forms to enable customers to derive the following advantages:

1. Easy and convenience of writing a cheque, only the relevant columns need to be filled in.
2. Avoidance of forgery and hence safety to banker and customer too.
3. Easy detection of fraud in a printed form is possible.
4. Ensure that the signature is drawn only according to the requirements of law.
5. Facility of verifying the customer's name by referring to chequebook issue record.
6. Easy countermanding of cheques by the customer; it is enough if the customer instructs to countermand the cheque number to the banker in case of fraud.
7. Counterfoils kept by the customer can be used as a record of payment made.
8. Popularity of name of the company or the individual where the names are printed on the cheque.

9. **CUSTOMER IDENTIFICATION AND KYC NORMS:** Meaning The term KYC for ' Know Your Customer'. KYC is used for identifying a customer of banking and a financial service company such as a Mutual Fund, Pension Fund, etc. KYC essentisally involves making reasonable efforts to determine true identity and beneficial ownership of accounts, source of funds, the nature of customer's business etc. The objective of KYC is to help the banks and financial institutions to manage their risks prudently. KYC is made available by the RBI by way of guidelines designed to prevent banks from being used, intentionally or unintentionally by criminal elements for money laundering. There are two important components of KYC, viz., Identity and Address. While identity remains the same, the address may change and hence the banks are required to periodically update their records.

10. **LEGAL COMPLIANCE:** KYC norms have legal backing of the RBI. RBI has issued guidelines to banks under Section Regulation Act, 1949 and Rule 7 of Prevention of Money – Laundering (Maintenance of Records of the Nature and Value of Transactions, Time for Furnishing Information and Verification and Maintenance of records of the Identity of the Clients of Banking Companies, Financial Institutions and Intermediaries) Rules, 2005. Any contravention thereof non- compliance will attract penalties under Banking Regulation A

11. **APPLICABILITY:** KYC norms are applicable to a bank customer. For this purpose, a customer includes the following:

- A person or entity that maintains an account and/ or has a business relationship with the bank.
- One on whose behalf the account is maintained i.e., the beneficial owner.
- Beneficiaries of transactions conducted by professional intermediaries such as Stock Brokers, Charted Accountants, Solicitors etc as permitted under the law.

- Any person or entity connected with a financial transaction which can pose significant reputational of other risks to the bank, say, wire transfer or issue of a high value demand draft as a single transaction. In certain cases, such as 'no frill accounts', which are meant providing basic banking facilities to poor and promote financial inclusion, KYC norms are rather relaxed by banks.

6.7. CUSTOMER IDENTIFICATION:

Customer identification involves identifying the customer and verifying the identity by using reliable, independent source documents, data or information. Banks have been advised by the RBI to lay down Customer Identification Procedure to be carried out different stages i.e., while establishing a banking relationship; carrying out a financial transaction or when the bank has a doubt about the authenticity/veracity or the adequacy of the previously obtained customers, KYC details about a customer are required to be updated periodically by the banker. Banks create a customer profile with details on social/ financial status, nature of business activity, information about his clients' business and their location, the purpose and reason for opening the account, the expected origin of the funds to be used within the relationship and details of occupation/employment, sources of wealth or income, expected monthly withdrawals etc. In the event of the transactions in the account are bring consistent with the customer profile already created, bank may ask for is any additional details/ documents as required. The ultimate objectives is to ensure that the account is not being used for any Money Laundering / Terrorist/ Criminal activities.

6.8. KYC DOCUMENTS FOR NORMAL CUSTOMERS:

There are two aspects of Customer Identification- One is establishing identity and the other is establishing present residential address. For establishing identity, the bank requires any authentic document carrying photo of the customer such as driving license/ passport/pan card/ voter' card etc. Though these documents carry the residential address of the customer, it may not be the present address. Therefore, in order to establish the present address of the customer, in addition to passport/driving license/voter's card / pan card; the bank may ask for utility bills such as Telephone/Electricity bill etc.

A Banker would ask for the following list of documents to establish the proof of identity and residence of a customer.

1. **FOR INDIVIDUALS:** The Banker will ask for copies of any the documents such as Aadhar card, Passport, Pan Card, Voter's Identity Card, Driving License, Identity Card and a letter from a recognized public authority or public servant verifying the identity and residence of the customer to the satisfaction of the bank. This would help the bank to establish the genuineness of the legal name or any other used by customer. To verify the documents such as Telephone bills, bank account statement, letter from any recognized public authority, electricity bill, ration card and letter from employer (Subject to satisfaction of the bank).

2. **FOR COMPANIES:** In the case of companies, the banker will ask for documents such as Certificate of Incorporation and the Memorandum of Association and the Articles of Association to verify the name of the company. Similarly, banks will look into the

resolution of the Board of Directors to open an account and identification of those who have authority to operate the account to determine the principal place of business.

6.9. CLOSING OF BANK ACCOUNTS:

Similar to the opening of account, banker has to adopt certain procedures while closing of account of a customer. At the time of closing an account, the banker should ask the customer to surrender the unused cheque along with the passbook. When a customer expresses his willingness to close the account in writing, the banker should settle his account. Before doing so, the banker has to arrive at the closing balance which maybe to the credit or debit of the customer. When the balance is to the credit of the customer, the banker to pay the amount either in person or send the same by a cheque to the address of customer. In case of undesirable customer, banker will give notice to the customer for closing the account. If the customer evades the request of the banker, a date will be fixed by the banker to close the account. This will be informed to the customer. On that particular day, the bank will close the account of the undesirable customer and send the credit balance to the address of the customer. A bank will chose the account of the customer under the following conditions

1. **DEATH OF A CUSTOMER:** When a customer dies, the contractual relationship stands terminated and operations in the account should be stopped as soon as the banker receives the notice of death. The banker should also obtain a copy of the death certificate. If the customer has left a will, the will has to be probated by a court and the amount should be paid to the executor, or administrator of the will. In the absence of a will, the legal heirs have to obtain a Succession Certificate. In that case, he should be satisfied through discreet enquiries that the customer died in state and that the legal heirs are not required to obtain a Succession Certificate for the disposal of other assets left by him. However, the legal heirs would have to execute a stamped indemnity form along with two sureties each good for the amount involved. The legal heirs are also required to submit affidavit from an independent person, indicating their heir- ship or submit an heir- ship certificates.

2. **INSOLVENCY OF CUSTOMER:** When a customer is adjusted insolvent by the court, an assignee will be appointed by the court. The account of the customer in the bank will not be operated by the official assignee appointed by the court. Thus, the account of the customer stands closed and the customer cannot operate the same.

3. **WHEN THE CUSTOMER BECOMES INSANE:** When the customer is of unsound mind, the account cannot be operated. As soon as the banker comes to know that the customer is of unsound mind, a doctor will be asked to judge the nature of unsound mind. If it is of permanent nature, the bank will have to close the account of the customer. But if the unsound mind is of a temporary nature, the account will be suspended till such time the customer becomes normal. It is on the basis of medical report, the banker will take a decision.

4. **GARNISHEE ORDER:** On the receipt of order from the court, the banker has to close the account of the customer. Such an order is called Garnishee Order. This order is of two parts. First, the court will ask the banker about the status of the account which is called Order Nisi. After receiving the explanation from the bank when court sends an absolute order, it is called Order Absolute. Thereupon, the account will be closed. The court orders the closure of the account when creditors of the customer convince the

court that in spite of sufficient funds at his disposal, the customer is unwilling to settle their claims.

5. **WITHDRAWAL OF POWER OF ATTORNEY:** When the customer gives permission to another person to operate his account during the absence of the customer, such an account is called Power of attorney account. When the customer withdraws such a power, the agent who was allowed to operate can no longer operate the account.

6. **DISSOLUTION OF FIRM:** When a partnership firm has an account in a bank, it is operated as long as the firm remains in operation. A firm gets dissolved due to the death, insolvency, insane, etc., of any partner or all the partners. The partners may also agree to dissolve the firm. In all the above cases, the account of the firm stands closed.

7. **WINDING UP OF COMPANY:** A company 's account will be operated as long as it is in operation. Once the company's winding up process commences, the account will operate by liquidator. The company's account stands closed.

8. **ASSIGNMENT OF CREDIT BALANCE:** When a customer informs the banker to assign his entire credit balance to third party, the account of the customer gets closed.

9. **CLOSING OF ACCOUNT OF ASSOCIATIONS AND INSTITUTION:** The accounts of association, institutions with the bank are operated as per their bye-laws. When they pass a resolution to close the account with the bank, it will be closed as per the provisions provided in their bylaws.

6.10. SUMMARY

Primarily, banks offer two kinds of deposit accounts. These are demand deposits like current/saving account and term deposits like fixed or recurring deposits. Banks help you save and grow your money. You can open all of the above types of deposit accounts with the same bank to manage your finances effectively. With digital banking services and mobile applications, today, you can open deposits online and monitor them conveniently. Just activate your internet banking account and access all your deposits on a single platform. The latest legal formalities and practices followed by a modern banker and the other guidelines necessary for opening various bank accounts have been enumerated. The details of KYC norms to be followed for opening bank accounts are given. We have also studied the circumstances for closure of a bank account.

6.11. KEY WORDS

CURRENT OR DEMAND DEPOSIT ACCOUNT: A current account, also called a demand deposit account, is a basic checking account. Consumers deposit money and the deposited money can be withdrawn as the account holder desires on demand. These accounts often allow the account holder to

SAVING ACCOUNT: Savings accounts offer account holders interest on their deposits; however, in some cases, account holders may incur a monthly fee if they do not maintain a set balance or a certain number of deposits. withdraw funds using bank cards, checks, or over-the-counter withdrawal slips.

SALARY ACCOUNTS: Although a Salary Account is also a type of Saving Account, it stands apart as your employer opens it for you for the sole purpose of depositing your remuneration. Unlike most accounts, where you can choose your preferred bank, you do not get to choose your preferred bank for your Salary Account. Companies usually tie up with one specific bank to open Salary Accounts for their employers.

FIXED DEPOSIT ACCOUNTS: A Fixed Deposit is a type of deposit that is ideal for conservative investors. A Fixed Deposit account is one where you deposit or put away a sum of money for a specific tenure with the bank.

PAY-IN-SLIP BOOK: The pay-in-slip book is a book that contains printed slips with perforated counterfoils to be filled in by the depositor or his agent at the time of depositing cash, cheques, drafts, etc., to the credit of his account.

6.12 SELF ASSESSMENT QUESTIONS:

I) ESSAY TYPE QUESTIONS:

1. Give the procedure for opening a bank account.
2. Bring out the significance of KYC (Know Your Customer) norms to a banker.
3. What are the merits of printed cheques forms?
4. Explain the circumstances under which a bank account is to closed.

II) SHORT TYPE QUESTIONS:

1. Current account
2. Savings account
3. Fixed deposit
4. Recurring deposit
5. KYC

6.13. SUGGESTED READINGS

1. Vijayalakshmi, R., and J. Srinivasan. "AN OVERVIEW OF INNOVATIVE PRODUCTS AND TECHNIQUES IN BANKING INDUSTRIES." *YMER Digital* 21, no. 08 (August 17, 2022): 676–79.
2. Gupta, Sumeet, and Renu Verma. "Comparative Analysis of Financial Performance of Private Sector Banks in India: Application of CAMEL Model." *Journal of Global Economy* 4, no. 2 (June 30, 2008): 160–80.
3. Tae Hwan. "Indian Banking Sector Reforms: Review and Prospects." *International Area Review* 8, no. 2 (June 2005): 167–89.
4. Kumar, Kishore, and Ajai Prakash. "Developing a framework for assessing sustainable banking performance of the Indian banking sector." *Social Responsibility Journal* 15, no. 5 (August 5, 2019): 689–709.

Dr.Shaik Ameer

LESSON - 7
NEGOTIABLE INSTRUMENTS

Aims and Objectives:

After reading this lesson the student would know:
- The various types of Negotiable instruments.
- Meaning and types of cheques.
- Bills of exchange and how it is different from cheque.
- Promissory note and related concepts.

Structure

7.1. Introduction
7.2. Meaning Of Negotiable Instruments
7.3. Cheque
7.4. How Cheque Work
7.5. History of Cheques
7.6. Features Of Cheque
7.7. Types Of Cheques
7.8. Bill of Exchange
7.9. Understanding Bills of Exchange
7.10. Example Of Bill of Exchange
7.11. Difference Between a Bill of Exchange and a cheque
7.12. Parties To a Bill of Exchange
7.13. Promissory Note
7.14. Meaning Of Promissory Note
7.15. Types Of Promissory Notes
7.16. Endorsement
7.17. How A Bank Endorsement Works
7.18. Types of Bank Endorsements
7.19. Summary
7.20 Key Words
7.21. Self-Assessment Questions
7.22 Suggested Readings

7.1. INTRODUCTION

A negotiable instrument is a signed document that promises a payment to a specified person or 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. Common examples of negotiable instruments include personal cheques, cashier's cheques, money orders, certificates of deposit (CDs), promissory notes, and traveller’s cheques. The person receiving the payment, known as the payee, must be named or otherwise indicated on

the instrument. Because they are transferable and assignable, some negotiable instruments may trade on a secondary market.

7.2. MEANING OF NEGOTIABLE INSTRUMENTS

Negotiable instruments are transferable, so the holder can take the funds as cash or use them for a transaction or other way as they wish. The fund amount listed on the document includes the specific amount promised, and must be paid in full either on-demand or at a specified time. A negotiable instrument can be transferred from one person to another. Once the instrument is transferred, the holder gains full legal title to the instrument.

These documents provide no other promise on the part of the entity issuing the instrument. In addition, no other instructions or conditions can be made for the bearer to receive the amount listed on the negotiable instrument. For an instrument to be negotiable, it must be signed, with a mark or signature, by the maker of the instrument the one issuing the draft. This entity or person is known as the drawer of funds. The term "negotiable" refers to the fact that the note in question can be transferred or assigned to another party; "non-negotiable" describes one that is firmly established and can't be adjusted or amended.

One of the more well-known negotiable instruments is the personal cheque. It serves as a draft, payable by the payer's financial institution once it's received, in the exact amount specified. Similarly, a cashier's cheque serves the same function but it requires the funds to be allocated, or set aside, for the payee prior to the cheque being issued. Money orders are similar to cheques but may or may not be issued by the payer's financial institution. Often, cash must be received from the payer before the money order is issued. Once the money order is received by the recipient, it can be exchanged for cash. Traveller's cheques function differently, as they require two signatures to complete a transaction. At the time of issue, the holder must sign the document to provide a specimen signature. Once the payer determines to whom the payment will be issued, a must be provided for payment. Traveller's cheques are generally used when someone is traveling to a foreign country and is looking for a payment method that provides an additional level of security against theft or fraud while traveling. Other common types of negotiable instruments include bills of exchange, promissory notes, drafts, and CDs.

A negotiable instrument, like as a personal or cashier's cheque, is a document that promises an amount of money to a particular person or entity. It's characterized by being transferable; ownership of the instrument can be handed over simply by delivery or by a valid endorsement. The most common types of negotiable instruments are personal, cashier's, traveller's cheques, money orders, promissory notes, and CDs.

7.3. CHEQUE

A cheque is a written, dated, and signed draft that directs a bank to pay a specific sum of money to the bearer. The person or entity writing the cheque is known as the payor or drawer, while the person to whom the cheque is written is the payee. The drawee, on the other hand, is the bank on which the cheque is drawn.

7.4. HOW CHEQUES WORK

A cheque is a bill of exchange or document that guarantees a certain amount of money. It is printed for the drawing bank to provide to an account holder (the payor) to use. The payor

writes the cheque and gives it to the payee, who then takes it to their bank for cash or to deposit into an account. Cheques essentially provide a way to instruct the bank to transfer funds from the payor's account to the payee or the payee's account. The use of cheques allows two or more parties to make a monetary transaction without using physical currency. Instead, the amount for which the cheque is written is a substitute for physical currency of the same amount. Cheques are generally written against a chequeing account, but they can also be used to move funds from a savings or other type of account. Cheques can be used to make bill payments, as gifts, or to transfer sums between two people or entities. They are generally seen as a more secure way of transferring money than cash, especially with large sums. If a cheque is lost or stolen, a third party is not able to cash it, as the payee is the only one who can negotiate the cheque. *Modern financial tools that work similarly to cheques in that they provide a substitute for physical currency include: debit and credit cards, money orders, wire transfers, and internet banking.*

7.5. HISTORY OF CHEQUES

Cheques have been in existence in one form or another since ancient times. Many people believe a type of cheque was used among the ancient Romans. Modern cheques, as we know them today, became popular in the 20th century. Cheque usage surged in the 1950s as the cheque process became automated and machines were able to sort and clear cheques. Cheque cards, first created in the 1960s, were the precursors to today's debit cards. Credit and debit cards—and other forms of electronic payment—have since overshadowed cheques as the dominant means of paying for most goods and services. Cheques are now somewhat uncommon but still occasionally used.

7.6. FEATURES OF CHEQUE

While not all cheques look alike, they generally share the same key features. The name and contact information of the person writing the cheque is located at the top left. The name of the bank that holds the drawer's account appears on the cheque as well.

There are a number of lines that need to be filled in by the payor:
The date must be written on the line in the top right corner of the cheque.
The payee's name goes on the first line in the centre of the cheque. This is indicated by the phrase "Pay to the Order Of."
The amount of the cheque in a dollar figure is filled out in the box next to the payee's name.
The amount written out in words goes on the line below the payee's name.
The payor signs the cheque on the line at the bottom right corner of the cheque. The cheque must be signed to be considered valid.

There is also a memo line in the bottom left corner of the cheque. The payor may use it to make notes, such as a reference number, an account number, or any particular reason for writing the cheque.

A series of coded numbers is found along the bottom edge of the cheque, directly underneath the memo line and extending toward the payor's signature line. These numbers are:
the bank's routing number
the payor's account number
the cheque numbers

In certain countries, such as Canada, the routing number is replaced with an institution number which represents the bank's identifying code and the transit or branch number where the account is held.

The back of the cheque has an endorsement line for the payee's signature when they are cashing or depositing the cheque. The receiving bank often stamps the back with a deposit stamp at the time it is deposited or cashed, after which it goes for clearing. Once the drawing bank receives the cheque, it is stamped again and filed. In some cases, the cheque is sent back to the payor.

7.7. TYPES OF CHEQUES

In addition to the standard personal cheque, types of cheques include certified cheques, cashier's cheques, and payroll cheques, which are all used for different purposes.

1. **CERTIFIED CHEQUE**: A certified cheque verifies that the drawer's account has enough funds to honour the amount of the cheque. In other words, the cheque is guaranteed not to bounce. To certify a cheque, it must be presented at the bank on which it is drawn, at which time the bank will ascertain its authenticity with the payor.
2. **CASHIER'S CHEQUE:** A cashier's cheque is guaranteed by the banking institution and signed by a bank cashier, which means the bank is responsible for the funds. This type of cheque is often required for large transactions, such as buying a car or house.
3. **PAYROLL CHEQUE:** Another type is a payroll cheque, or paycheque, which an employer issues to compensate an employee for their work. In recent years, physical paycheques have given way to direct deposit systems and other forms of electronic transfer. A payroll cheque is another example of a type of cheque; however, it is issued by an employer to compensate for the employee's work. Direct deposit and other forms of electronic transfers have overtaken the traditional, physical paycheque.
4. **PERSONAL CHEQUE:** A personal cheque is a cheque your bank issues that has your routing and account number printed on it. The payor needs to fill out the cheque, since it is otherwise blank. The payee will then deposit the cheque in their account, which transfers funds to the recipient.
5. **BOUNCED CHEQUE:** When someone writes a cheque for an amount larger than what is held in their chequeing account, the cheque cannot be negotiated. This is referred to as a bounced cheque. As mentioned before, a cheque has the ability to bounce if a bank has not guaranteed it. This means the payor wrote a cheque for an amount larger than what is in their account. The payor has non-sufficient funds (NSF), and will likely incur a fee for attempting to overdraw on the account. Banks have different policies on bounced cheques. Oftentimes, a bank charges overdraft fees or nonsufficient funds fees on bounced cheques. Some banks may provide a grace period, such as 24 hours, in which time you can deposit funds to avoid the overdraft fees.
6. **VOIDED CHEQUE:** A voided cheque is a paper cheque that has the word "VOID" written across the front of it.
7. **MONEY CHEQUE:** A money order is a secure form of payment, representing an amount of money. You will pay the full amount of the cheque, plus a small fee when you purchase it. Unlike cheques, a money order is not directly pulled from your account.

They are useful if you may not want to use a personal cheque which includes personal information.

7.8. WHAT IS BILL OF EXCHANGE?

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

7.9. UNDERSTANDING BILLS OF EXCHANGE

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

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

Bills of exchange generally do not pay interest, making them, in essence, post-dated cheques. They may accrue interest if not paid by a certain date, however, in which case the rate must be specified on the instrument. They can, conversely, be transferred at a discount before the date specified for payment.1 A bill of exchange must clearly detail the amount of money, the date, and the parties involved, including the drawer and drawee.

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

Bills of exchange are useful in international trade because they help buyers and sellers deal with the risks associated with exchange rate fluctuations and differences in legal jurisdictions. The difference between a promissory note and a bill of exchange is that the latter is transferable and can bind one party to pay a third party that was not involved in its creation. Banknotes are common forms of promissory notes. A bill of exchange is issued by the creditor and orders a debtor to pay a particular amount within a given period of time. The promissory note, on the other hand, is issued by the debtor and is a promise to pay a particular amount of money in a given period.

7.10. EXAMPLE OF BILL OF EXCHANGE

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

7.11. DIFFERENCE BETWEEN A BILL OF EXCHANGE AND A CHEQUE:

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

7.12. WHO ARE THE PARTIES TO A BILL OF EXCHANGE?

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

7.13. PROMISSORY NOTE

A promissory note is a legal and a financial instrument that is written between three financing parties: the maker, the lender, and the payee/the borrower. This note contains terms of the issuance, details of the debt like the circumstances of the loan, who the bearer is and from whom, the maturity date, the amount payable with interest or not, and more. It is a written promise by the lender assuring the borrower that they can avail money from the lender as specified after agreement. The maker can be the lender too.

7.14. MEANING OF PROMISSORY NOTE

Promissory notes are a written promise made by the maker for individuals and companies to see sources of finance from other than just banks. The note attests the validity of the lender and promises the credit worthiness of the borrower, since a promissory note only promises the repayment of the loan or credit that has been lent. In India, a promissory note can be issued under Section 4 of the Negotiable Instruments Act, 1881, therefore making it a legal instrument and binding the parties by law, the source of funds being an unregulated method. Even so, promissory notes are classified into secured and unsecured notes. Secured notes function a lot like bank loans with the requirement of a collateral, whereas unsecured notes require only a healthy credit score. Promissory notes are also considered securities, and are thus traded on the money market in India by banks and traders. They lay alongside bills of exchange, IOUs etc. but in comparison, contain a promise and the steps to fulfil the promise.

7.15. TYPES OF PROMISSORY NOTES:

There are several types of promissory notes. The features that differ between types of notes include how and whether the promissory note is secured, detail of repayment requirements, and terms of repayment.

1. **SIMPLE PROMISSORY NOTE**: As the name suggests, this is a promissory note with only the basics included: the amount owed, the terms, and payment schedule. Simple promissory notes are more common for smaller loans with a single borrower.
2. **SECURED PROMISSORY NOTE:** A secured promissory note is an agreement where the borrower puts something of value up as collateral to safeguard the value of the loan. In the event the borrower is unable to make payments and defaults on the loan, a secured promissory note empowers the lender to take possession of the collateral in lieu of payment.
3. **UNSECURED PROMISSORY NOTE**: An unsecured promissory note does not require the borrower to provide any collateral in order to receive the loan. However, an unsecured promissory note is still a contract, and as such the lender has legal options to collect any overdue payments. Unsecured promissory notes are common in real estate transactions, because the mechanism for securing the loan is the mortgage, rather than separate collateral associated with the promissory note. While they are very similar, the unsecured promissory note only represents the borrower's promise to pay the full amount plus interest, while a mortgage puts a lien on the real estate that allows the lender to foreclose on it in the case of non-payment.
4. **MASTER PROMISSORY NOTE:** A master promissory note is an ongoing agreement between the borrower and the lender. Similar to a master services agreement, a master promissory note allows both parties to agree to a set of terms that will govern multiple loan agreements. This type of promissory note is commonly used for student loans, where multiple loans are expected to be taken out over a relatively short period of time.
5. **OPEN-ENDED PROMISSORY NOTE:** An open-ended promissory note is similar to a line of credit. Rather than receiving the full amount of funds immediately, the borrower only receives a portion and pays that back over the period of time agreed to in the promissory note. This allows the borrower to draw additional funds later that are governed by the same promissory note without having to take more than they initially need.
6. **DEMANDED PROMISSORY NOTE**: A demand promissory note foregoes details about multiple payments in favour of a single payment being due upon demand of the lender. These types of promissory notes generally have requirements for advance notice of intent to collect.
7. **BALLOON PROMISSORY NOTE:** A balloon promissory note has all the usual repayment requirement details, with one important distinction. Instead of an even amount of payments over the term of the loan, smaller payments are made at first and a single large payment is made at the end. These can be appealing for small business

borrowers because it allows them more runway for building revenue before needing to pay off the loan.

7.16. WHAT IS ENDORSEMENT

A bank endorsement is a guarantee given by a bank or credit union. It ensures that the bank will fully back a negotiable instrument made by one of its customers in a third-party transaction. Negotiable instruments are written documents that serve as a substitute for money when purchasing something, for instance, cheques, bank drafts, promissory notes, and even certificates of deposit (although certificates of deposit are almost never negotiable).

In the literal sense, a bank endorsement occurs when the bank stamps, signs, or uses some other form of authorization to guarantee that a negotiable instrument will be honoured. So, in plain and simple terms, a bank endorsement is your bank's promise to a seller that they will pay for something you purchased even if you cannot. A bank endorsement signifies to a seller that a negotiable instrument will be honoured when presented to the customer's bank for collection, provided that all terms of the transaction agreement are met.

Essentially, a banker's acceptance or time draft is a negotiable document where a bank unconditionally agrees to fulfil a payment obligation on behalf of the customer that created it. Bank endorsements are common in international trade. For example, an importer may not want to pay an exporter in full before receiving goods and an exporter may not want to ship goods before being paid. So, as a solution, a bank serves as a middle party offering a guarantee to the exporter and accepting payment from the importer at a later date.

7.17. HOW A BANK ENDORSEMENT WORKS

A bank endorsement works when a customer creates a negotiable instrument, such as a cheque. Then the customer gets the bank to guarantee that the funds will be paid to the recipient when the cheque is presented.

Bank endorsements are commonly used in delayed-payment agreements that involve international trade. The agreement is typically between a buyer and a seller who do not have a previous working relationship. In this case, the seller wants to guarantee that they will receive payment from a buyer they do not know. So when a buyer orders something from overseas that needs to be shipped, they may want to pay for the merchandise at a later date after receiving the shipment. In this situation, the seller would assume all of the risks if the buyer is unable to pay. So the seller could request that the buyer receive a bank endorsement from their bank.

The buyer could then create a negotiable instrument through their bank known as a banker's acceptance or time draft. Once the bank accepts and authorizes the draft, it is now fully backed by the bank. After the bank endorsement is obtained, the seller is then guaranteed payment. Additionally, the risks are transferred away from the seller and onto the bank. A bank will not provide a bank endorsement unless it can verify that both parties are trustworthy.

Let's look at a transaction that might require a bank endorsement. Imagine that you own a car dealership in the U.S. and want to purchase 500 cars online from a European wholesaler. You both agree on a price and that the payment will be sent via a cheque. However, since you don't have a history with the seller, they may request you get a bank endorsement of the cheque.

This guarantees the seller that they will receive payment for the cars whether you can meet the financial obligation or not.

7.18. TYPES OF BANK ENDORSEMENTS

The types of bank endorsements are divided in the given below:

1. **BANKER'S ACCPTANCE:** One type of bank endorsement is a banker's acceptance, also known as a time draft. The time draft must be originated and accepted by the bank of the person creating the draft. The time draft acts as a written order that specifies whom to pay, how much, and what date. An authorized bank employee must then stamp the draft as "accepted" and sign it before the draft becomes the total liability of the bank. When a bank endorsement is structured using this process, the seller can ship the order with confidence that they will receive the payment on time. The buyer can also rest assured that the transaction will occur according to the agreed-upon terms. Ultimately, they won't be assuming the risk that the buyer won't pay. Receiving a banker's acceptance, or BA, requires a letter of credit.

2. **LETTER OF CREDIT:** Another type of bank endorsement is a letter of credit. The letter of credit works similar to the banker's acceptance. The issuing bank guarantees a seller or exporter that they will receive payment for their goods if the buyer can not pay. If the seller agrees to this type of bank endorsement, the buyer, or importer, has their bank issue a letter of credit to the seller on behalf of the buyer's bank. Then, once the goods have shipped, the seller can present their documents to the issuing bank and collect payment. Letters of credit are typically irrevocable unless all parties consent to cancel the agreement.

3. **STAMP:** Another form of bank endorsement occurs when a receiving bank stamps a cheque. The stamp is typically placed on the back. For instance, if you were cashing or depositing a cheque into your bank account. A bank endorsement stamp is specific to the receiving bank. It typically includes a routing number, transit number, name and location of the bank, and the endorsement date. This type of bank endorsement leaves behind a digital and paper trail that can be traced should any issues arise with the cashing or proper posting of the cheque.

7.19. SUMMARY

Negotiable instruments are transferable, so the holder can take the funds as cash or use them for a transaction or other way as they wish. The fund amount listed on the document includes the specific amount promised, and must be paid in full either on-demand or at a specified time. Bank deposits consist of money placed into banking institutions for safekeeping. These deposits are made to deposit accounts such as savings accounts, chequeing accounts, and money market accounts at financial institutions. A cheque is a written, dated, and signed draft that directs a bank to pay a specific sum of money to the bearer. The person or entity writing the cheque is known as the payor or drawer, while the person to whom the cheque is written is the payee. The drawee, on the other hand, is the bank on which the cheque is drawn. While not all cheques look alike, they generally share the same key features. The name and contact information of the person writing the cheque is located at the top left. The name of the bank that holds the drawer's account appears on the cheque as well. A bill of exchange is a written order used primarily in international trade that binds one party to pay a

fixed sum of money to another party on demand or at a predetermined date. Bills of exchange are similar to cheques and promissory notes—they can be drawn by individuals or banks and are generally transferable by endorsements. A bank endorsement is a guarantee given by a bank or credit union. It ensures that the bank will fully back a negotiable instrument made by one of its customers in a third-party transaction. Negotiable instruments are written documents that serve as a substitute for money when purchasing something, for instance, cheques, bank drafts, promissory notes, and even certificates of deposit (although certificates of deposit are almost never negotiable).

7.20. KEY WORDS

Negotiable instrument - A negotiable instrument is a signed document that promises a payment to a specified person or 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. Common examples of negotiable instruments include personal cheques, cashier's cheques, money orders, certificates of deposit (CDs), promissory notes, and traveller's cheques.

Cheque - A cheque is a written, dated, and signed draft that directs a bank to pay a specific sum of money to the bearer. The person or entity writing the cheque is known as the payor or drawer, while the person to whom the cheque is written is the payee.

Cashier's Cheque: A cashier's cheque is guaranteed by the banking institution and signed by a bank cashier, which means the bank is responsible for the funds. This type of cheque is often required for large transactions, such as buying a car or house.

Personal Cheque: A personal cheque is a cheque your bank issues that has your routing and account number printed on it. The payor needs to fill out the cheque, since it is otherwise blank. The payee will then deposit the cheque in their account, which transfers funds to the recipient.

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

promissory note - A promissory note is a legal and a financial instrument that is written between three financing parties: the maker, the lender, and the payee/the borrower. This note contains terms of the issuance, details of the debt like the circumstances of the loan, who the bearer is and from whom, the maturity date, the amount payable with interest or

7.21 SELF ASSESSMENT QUESTIONS:

I) ESSAY TYPE QUESTIONS:

1.What is called negotiable instrument?
2. What is meant by promissory note and types of promissory notes?
3. Define bank account? And types of the bank accounts?

II) SHORT TYPE QUESTIONS:

1. Define endorsement?
2. Explain about cheque?
3. 3. What is bill of exchange?

7.22 SUGGESTED READINGS

1. Bandiera, Oriana, Gerard Caprio, Patrick Honohan, and Fabio Schiantarelli. 2000. “Does Financial Reform Raise or Reduce Saving?” Review of Economics and Statistics 82(2): 239–63.
2. Berger, Allen, Leora Klapper, and Gregory F. Udell. 2001. “The Ability of Banks to Lend to Informationally Opaque Small Businesses.” Journal of Banking and Finance. Forthcoming.
1. 3.Row publishers. Joshi, P. R. (2001). Research Methodology. Kathmandu: Buddha Academic Publishers and Distributors Pvt. Ltd.
2. 4.Kothari, C.R. (1994). Quantitative Techniques (3rd ed). New Delhi: Vikas Publishing House Pvt. Ltd.
4. Meir K. (1996). Financial Markets and Institutions. New Delhi: Tata MC Graw-Hill Publishing Co. Ltd.

Dr.Shaik Ameer

LESSON - 8
PRINCIPLES OF LENDING

Aims and Objectives:

After reading this lesson the student would know:

- The principles of lending
- Meaning and types of loans
- Types of mortgages
- Priority sector lending and types.

Structure

8.1 Introduction
8.2. Meaning of Loans
8.3. Different Types of Loans
8.4. Things To Consider Before Applying for Loan
8.5. Components of a Loan
8.6. Mortgage Loan
8.7. How To Mortgage Work
8.8 Mortgage Process
8.9. Types of Mortgages
8.10. Average Mortgage Rates (As On 2024)
8.11. How To Compare Mortgages
8.12. Priority Sector Lending
8.13. Meaning Of Priority Sector Lending
8.14. Different Types of Priority Sector Lending
8.15. Activities Under Priority Sector Lending
8.16. Summary
8.17. Key Words
8.18 Self-Assessment Questions
8.19 Suggested Readings

8.1 INTRODUCTION

The term loan refers to a type of credit vehicle in which a sum of money is lent to another party in exchange for future repayment of the value or principal amount. In many cases, the lender also adds interest or finance charges to the principal value, which the borrower must repay in addition to the principal balance. Loans may be for a specific, one-time amount, or they may be available as an open-ended line of credit up to a specified limit. Loans come in many different forms including secured, unsecured, commercial, and personal loans.

Here's how the loan process works: When someone needs money, they apply for a loan from a bank, corporation, government, or other entity. The borrower may be required to provide specific details such as the reason for the loan, their financial history, Social Security number (SSN), and other information. The lender reviews this information as well as a person's debt-to-income (DTI) ratio to determine if the loan can be paid back. Based on the

applicant's creditworthiness, the lender either denies or approves the application. The lender must provide a reason should the loan application be denied. If the application is approved, both parties sign a contract that outlines the details of the agreement. The lender advances the proceeds of the loan, after which the borrower must repay the amount including any additional charges, such as interest. The terms of a loan are agreed to by each party before any money or property changes hands or is disbursed. If the lender requires collateral, the lender outlines this in the loan documents. Most loans also have provisions regarding the maximum amount of interest, in addition to other covenants, such as the length of time before repayment is required.

8.2. MEANING OF LOANS

A loan is a sum of money that one or more individuals or companies borrow from banks or other financial institutions so as to financially manage planned or unplanned events. In doing so, the borrower incurs a debt, which he has to pay back with interest and within a given period of time. he recipient and the lender must agree on the terms of the loan before any money changes hands. In some cases, the lender requires the borrower to offer an asset up for collateral, which will be outlined in the loan document. A common loan for American households is a mortgage, which is taken for the purchase of a property.

Loans can be given to individuals, corporations, and governments. The main idea behind taking out one is to get funds to grow one’s overall money supply. The interest and fees serve as sources of revenue for the lender.

8.3. DIFFERENT 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. Most people apply for secured loans when they want to borrow large sums of money. Since lenders are not typically willing to lend large amounts of money without collateral, they hold the recipients’ assets as a form of guarantee. 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. Depending on an individual’s financial wants,

he may choose to use all or just a portion of his credit limit. Every time this person pays for an item with his credit card, the remaining available credit decreases. 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. However, if the borrower wants more money, he needs to apply for another loan from scratch. The process entails presenting documents to prove that they are credit-worthy and waiting for approval. 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).

4. **REVOLVING VS TERM LOAN**: Loans can also be described as revolving or term. A revolving loan can be spent, repaid, and spent again, while a term loan refers to a loan paid off in equal monthly instalments over a set period. A credit card is an unsecured, revolving loan, while a home equity line of credit (HELOC) is a secured, revolving loan. In contrast, a car loan is a secured, term loan, and a signature loan is an unsecured, term loan.

5. **EDUCATIONAL LOAN**: Education loans are financing instruments that aid the borrower pursue education. The course can either be an undergraduate degree, a postgraduate degree, or any other diploma/certification course from a reputed institution/university. You must have the admission pass provided by the institution to get the financing. The financing is available both for domestic and international courses.

6. **PERSONAL LOAN:** Whenever there is a liquidity issue, you can go for a personal loan. The purpose of taking a personal loan can be anything from repaying an old debt, going on vacation, funding for the downpayment of a house/car, and medical emergency to purchasing big-ticket furniture or gadgets. Personal loans are offered based on the applicant's past relationship with the lender and credit score

7. **VEHICLE LOAN:** Vehicle loans finance the purchase of two-wheeler and four-wheeler vehicles. Further, the four-wheeled vehicle can be a new one or a used one. Based on the on-road price of the vehicle, the loan amount will be determined by the lender. You may have to get ready with a downpayment to get the vehicle as the loan rarely provides 100% financing. The vehicle will be owned by the lender until full repayment is made.

8. **HOME LOAN**: Home loans are dedicated to receiving funds in order to purchase a house/flat, construct a house, renovate/repair an existing house, or purchase a plot for the construction of a house/flats. In this case, the property will be held by the lender and the ownership will be transferred to the rightful owner upon completion of repayments.

9. **GOLD LOAN**: Many financiers and lenders offer cash when the borrower pledges physical gold, may it be jewellery or gold bars/coins. The lender weighs the gold and calculates the amount offered based on several checks of purity and other things. The money can be utilised for any purpose. The loan must be repaid in monthly instalments

so the loan can be cleared by the end of the tenure and the gold can be taken back to custody by the borrower. If the borrower fails to make the repayments on time, the lender reserves the right to take over the gold to recover the losses.

10. **LOAN AGAINST ASSETS:** Similar to pledging gold, individuals and businesses pledge property, insurance policies, FD certificates, mutual funds, shares, bonds, and other assets in order to borrow money. Based on the value of the pledged assets, the lender will offer a loan with some at hand. The borrower needs to make repayments on time so that he/she can get custody of the pledged assets at the end of the tenure. Failing to do so, the lender can sell the assets to recover the defaulted money.

8.4. THINGS TO CONSIDER BEFORE APPLYING FOR 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. So, the higher the credit score, the higher the likelihood of the individual getting approved for a loan. With a good credit score, an individual is also having a better chance of getting favourable terms.

2. **INCOME AND EMPLOYMENT HISTORY:** Your monthly or annual income and employment history plays a crucial role in loan approval as well. Based on your income and income stability in the form of consistent and stable work history, the lender may or may not get convinced that you will be able to repay the loan. Even if you are self-employed, the lender assumes that your business is running well for the past few years and your business's turnover is satisfactory.

   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. However, if the applicant is self-employed, all he needs to submit is his tax return for the past two or more years and invoices where applicable.

3. **MONTHLY OBLIGATIONS:** In addition to their income, it's also crucial that a loan applicant evaluates their monthly obligations. For instance, an individual may be receiving a monthly income of $6,000 but with monthly obligations amounting to $5,500. Lenders may not be willing to give loans to such people. It explains why most lenders ask applicants to list all their monthly expenses, such as rent and utility bills.

   A loan is a sum of money that an individual or company borrows from a lender. It can be classified into three main categories, namely, unsecured and secured, conventional, and open-end and closed-end loans. However, regardless of the loan that one chooses to apply for, there are a few things that he should first assess, such as his monthly income, expenses, and credit history.

4. **DEBT-TO-INCOME RATIO:** In addition to one's income, lenders also check the borrower's credit history to check how many active loans they have at the same time. A high level of debt indicates that the borrower may have difficulty repaying their debts.

5. **COLLATERAL:** Based on the collateral you provide and its current market value, the lender may decide on the interest rate applicable to your loan. Providing collateral will make the deal more secure from the lender's perspective, which may result in more trust and less interest rate. An unsecured loan is infamous as it includes a higher interest rate comparatively.

6. **DOWN PAYMENT:** The money you have saved and the effective execution of your saving plan towards a down payment will increase the lender's trust in you. The higher the down payment, the lower is the loan amount requirement.

8.5. COMPONENTS OF A LOAN:

There are several important terms that determine the size of a loan and how quickly the borrower can pay it back:

1. **PRINCIPAL LOAN:** This is the original amount of money that is being borrowed.
2. **TERM LOAN:** The amount of time that the borrower has to repay the loan.
3. **INTEREST RATE:** The rate at which the amount of money owed increases, usually expressed in terms of an annual percentage rate (APR).
4. **LOAN PAYMENTS:** The amount of money that must be paid every month or week in order to satisfy the terms of the loan. Based on the principal, loan term, and interest rate, this can be determined from an amortization table.

In addition, the lender may also tack on additional fees, such as an origination fee, servicing fee, or late payment fees. For larger loans, they may also require collateral, such as real estate or a vehicle. If the borrower defaults on the loan, these assets may be seized to pay off the remaining debt

8.6. MORTGAGE LOAN

A mortgage is a type of loan used to purchase or maintain a home, plot of land, or other types of real estate. The borrower agrees to pay the lender over time, typically in a series of regular payments that are divided into principal and interest. The property then serves as collateral to secure the loan. A borrower must apply for a mortgage through their preferred lender and ensure that they meet several requirements, including minimum credit scores and down payments. Mortgage applications go through rigorous underwriting process before they reach the closing phase. Mortgage types, such as conventional or fixed-rate loans, vary based on the needs of the borrower.

8.7. HOW TO MORTGAGE WORK:

Individuals and businesses use mortgages to buy real estate without paying the entire purchase price up front. The borrower repays the loan plus interest over a specified number of years until they own the property free and clear. Most traditional mortgages are fully-amortizing. This means that the regular payment amount will stay the same, but different proportions of principal vs. interest will be paid over the life of the loan with each payment. Typical mortgage terms are for 15 or 30 years. Mortgages are also known as liens against property or claims on property. If the borrower stops paying the mortgage, the lender can foreclose on the property. For example, a residential homebuyer pledges their house to their lender, which then has a claim on the property. This ensures the lender's interest in the

property should the buyer default on their financial obligation. In the case of a foreclosure, the lender may evict the residents, sell the property, and use the money from the sale to pay off the mortgage debt.

8.8 MORTGAGE PROCESS

Would-be borrowers begin the process by applying to one or more mortgage lenders. The lender will ask for evidence that the borrower is capable of repaying the loan. This may include bank and investment statements, recent tax returns, and proof of current employment. The lender will generally run a credit check as well.

If the application is approved, the lender will offer the borrower a loan of up to a certain amount and at a particular interest rate. Homebuyers can apply for a mortgage after they have chosen a property to buy or even while they are still shopping for one, thanks to a process known as pre-approval. Being pre-approved for a mortgage can give buyers an edge in a tight housing market because sellers will know that they have the money to back up their offer.

Once a buyer and seller agree on the terms of their deal, they or their representatives will meet at what's called a closing. This is when the borrower makes their down payment to the lender. The seller will transfer ownership of the property to the buyer and receive the agreed-upon sum of money, and the buyer will sign any remaining mortgage documents. The lender may charge fees for originating the loan (sometimes in the form of points) at the closing. There are hundreds of options on where you can get a mortgage. You can get a mortgage through a credit union, bank, mortgage-specific lender, online-only lender, or mortgage broker. No matter which option you choose, compare rates across types to make sure that you're getting the best deal.

8.9. TYPES OF MORTGAGES

Mortgages come in a variety of forms. The most common types are 30-year and 15-year fixed-rate mortgages. Some mortgage terms are as short as five years, while others can run 40 years or longer. Stretching payments over more years may reduce the monthly payment, but it also increases the total amount of interest that the borrower pays over the life of the loan. Within the different term lengths are numerous types of home loans, including Federal Housing Administration (FHA) loans, U.S. Department of Agriculture (USDA) loans, and U.S. Department of Veterans Affairs (VA) loans available for specific populations that may not have the income, credit scores, or down payments required to qualify for conventional mortgages. The following are just a few examples of some of the most popular types of mortgage loans available to borrowers.

1. **FIXED-RATE MORTGAGES:** The standard type of mortgage is fixed-rate. With a fixed-rate mortgage, the interest rate stays the same for the entire term of the loan, as do the borrower's monthly payments toward the mortgage. A fixed-rate mortgage is also called a traditional mortgage.

   Mortgage lending discrimination is illegal. If you think you've been discriminated against based on race, religion, sex, marital status, use of public assistance, national origin, disability, or age, there are steps that you can take. One such step is to file a report with the Consumer Financial Protection Bureau (CFPB) or the U.S. Department of Housing and Urban Development (HUD).

2. **ADJUSTABLE-RATE MORTGAGE (ARM):** With an adjustable-rate mortgage (ARM), the interest rate is fixed for an initial term, after which it can change periodically based on prevailing interest rates. The initial interest rate is often a below-market rate, which can make the mortgage more affordable in the short term but possibly less affordable long-term if the rate rises substantially. ARMs typically have limits, or caps, on how much the interest rate can rise each time it adjusts and in total over the life of the loan. A 5/1 adjustable-rate mortgage is an ARM that maintains a fixed interest rate for the first five years and then adjusts each year after that.

3. **INTEREST-ONLY LOANS:** Other, less common types of mortgages, such as interest-only mortgages and payment-option ARMs, can involve complex repayment schedules and are best used by sophisticated borrowers. These types of loans may feature a large balloon payment at its end. Many homeowners got into financial trouble with these types of mortgages during the housing bubble of the early 2000s.

4. **REVERSE MORTGAGES:** As their name suggests, reverse mortgages are a very different financial product. They are designed for homeowners age 62 or older who want to convert part of the equity in their homes into cash. These homeowners can borrow against the value of their home and receive the money as a lump sum, fixed monthly payment, or line of credit. The entire loan balance becomes due when the borrower dies, moves away permanently, or sells the home. Within each type of mortgage, borrowers have the option to buy discount points to buy their interest rate down. Points are essentially a fee that borrowers pay up front to have a lower interest rate over the life of their loan. When comparing mortgage rates, make sure you are comparing rates with the same number of discount points for a true apples-to-apples comparison.

8.10. AVERGE MORTGAGE RATES (AS ON 2024):

How much you'll have to pay for a mortgage depends on the type of mortgage (such as fixed or adjustable), its term (such as 20 or 30 years), any discount points paid, and interest rates at the time. Interest rates can vary from week to week and from lender to lender, so it pays to shop around.

Mortgage rates sank to historic lows in 2020 and 2021, recording their cheapest levels in almost 50 years. From roughly the start of the pandemic (i.e., April 2020) to Jan. 2022, the 30-year rate average wavered below 3.50%—including an ultimate low of 2.65 per cent. But 2022 and 2023 saw mortgage rates skyrocket, setting records in the opposite direction. The 30-year average breached the 7.0 per cent threshold for the first time in Oct. 2022, and this past October, it was closer to 8%, notching a 23-year peak reading of 7.79 per cent s. Since then the 30-year mortgage rate has come down by over a percentage point as of Feb. 2024. According to the Federal Home Loan Mortgage Corp., average interest rates looked like this as of Feb. 2024:

30-year fixed-rate mortgage: 6.77 per cent.
15-year fixed-rate mortgage: 6.12 per cent.

8.11. HOW TO COMPARE MORTGAGES

Banks, savings and loan associations, and credit unions were virtually the only sources of mortgages at one time. Today, a burgeoning share of the mortgage market includes nonbank lenders, such as Better, loan Depot, Rocket Mortgage, and SoFi. If you're shopping for a mortgage, an online mortgage calculator can help you compare estimated monthly payments, based on the type of mortgage, the interest rate, and how large a down payment you plan to make. It also can help you determine how expensive a property you can reasonably afford. In addition to the principal and interest that you'll be paying on the mortgage, the lender or mortgage servicer may set up an escrow account to pay local property taxes, homeowners insurance premiums, and certain other expenses. Those costs will add to your monthly mortgage payment. Also, note that if you make less than a 20% down payment when you take out your mortgage, your lender may require that you purchase private mortgage insurance (PMI), which becomes another added monthly cost

8.12. PRIORITY SECTOR LENDING

The Reserve Bank of India decides to allot funds to predetermined priority sectors of the economy that may require credit and financial assistance, especially in cases where the lack of PSL will lead to the heavy losses to the participants of that sector in some cases. Priority Sectors Lending is the role exercised by the RBI to banks, imploring them to dedicate funds for specific sectors of the economy like agriculture and allied activities, education and housing and food for the poorer population.

8.13. MEANING OF PRIORITY SECTOR LENDING:

The goal of a PSL initiative is to provide credit to the weaker sections of the society, as opposed to funding only profitable sectors or spaces that are solely important to economic growth. All sectors considered as a priority are able to easily access financial support like apply for loans that the banks are required to allot at a lower interest rate. The following fall into the priority sectors under the policy: agriculture (including micro financing groups like SHGs, JLGs, individual farmers, and other institutions dedicated to individuals working in the sector), micro, small and medium scale enterprises (MSMEs) and SSIs, Educational and Small Scale Industrial loans, Housing loans and other micro credit finances. When banks overreach their PSL targets and need additional funding to raise funds for the priority sectors, they are able to issue PSL certificates (PSLCs) only to the extent of the amount banks are allowed to lend in that specific sector. These certificates can be traded on RBI's e-Kuber platform.

8.14. DIFFERENT TYPES OF PRIORITY SECTOR LENDING

The broad categories of priority sector for all scheduled commercial banks are as under:

1. **AGRICULTURE AND ALLIED ACTIVITIES (DIRECT AND INDIRECT FINANCE)**: Direct finance to agriculture shall include short, medium and long term loans given for agriculture and allied activities directly to individual farmers, Self-Help Groups (SHGs) or Joint Liability Groups (JLGs) of individual farmers without limit and to others (such as corporate, partnership firms and institutions) up to Rs. 20 lakh, for taking up agriculture/allied activities.

   Indirect finance to agriculture shall include loans given for agriculture and allied activities as specified in Section I, appended. This distinction between direct and

indirect agriculture is dispensed with. Instead, the lending to agriculture sector has been re-defined to include (i) Farm Credit (which will include short-term crop loans and medium/long-term credit to farmers) (ii) Agriculture Infrastructure and (iii) Ancillary Activities.

2. **SMALL SCALE INDUSTRIES (DIRECT AND INDIRECT FINANCE):** Direct finance to small scale industries (SSI) shall include all loans given to SSI units which are engaged in manufacture, processing or preservation of goods and whose investment in plant and machinery (original cost) excluding land and building does not exceed the amounts specified in Section I, appended.

   Indirect finance to SSI shall include finance to any person providing inputs to or marketing the output of artisans, village and cottage industries, hand-looms and to cooperatives of producers in this sector.
3. **SMALL BUSINESS / SERVICE ENTERPRISES:** shall include small business, retail trade, professional & self-employed persons, small road & water transport operators and other service enterprises as per the definition given in Section I and other enterprises that are engaged in providing or rendering of services, and whose investment in equipment does not exceed the amount specified in Section I, appended.
4. **MICRO CREDIT:** Provision of credit and other financial services and products of very small amounts not exceeding Rs. 50,000 per borrower to the poor in rural, semi-urban and urban areas, either directly or through a group mechanism, for enabling them to improve their living standards, will constitute micro credit.
5. **EDUCATION LOANS:** Education loans include loans and advances granted to only individuals for educational purposes up to Rs. 10 lakh for studies in India and Rs. 20 lakh for studies abroad, and do not include those granted to institutions;
6. **HOUSING LOANS:** Loans up to Rs. 35 lakh in metropolitan cities where population is above 10 lakh and Rs. 25 Lakh at other center s for construction/purchase of a dwelling unit per family provided total cost of the unit in metropolitan centres and at other centres does not exceed Rs. 45 Lacs and Rs. 30 Lacs respectively. (excluding loans granted by banks to their own employees) and loans given for repairs to the damaged houses of individuals up to Rs.5 lakh in metropolitan centres and Rs. 2 Lakh at other centres.
7. Investments by banks in securitised assets, representing loans to agriculture (direct or indirect), small scale industries (direct or indirect) and housing, shall be eligible for classification under respective categories of priority sector (direct or indirect) depending on the underlying assets, provided the securitised assets are originated by banks and financial institutions and fulfill the Reserve Bank of India guidelines on securitisation. (3) **Under Weaker Sections :** Priority sector loans to the following borrowers are considered under Weaker Sections category:-

   (a) Small and marginal farmers;
   (b) Artisans, village and cottage industries where individual credit limits do not exceed Rs 1 Lakh ;
   (c) Beneficiaries of Swarnajayanti Gram Swarozgar Yojana (SGSY), now National Rural Livelihood Mission (NRLM);
   (d) Scheduled Castes and Scheduled Tribes;
   (e) Beneficiaries of Differential Rate of Interest (DRI) scheme;
   (f) Beneficiaries under Swarna Jayanti Shahari Rozgar Yojana (SJSRY);
   (g) Beneficiaries under the Scheme for Rehabilitation of Manual Scavengers (SRMS);

(h) Loans to Self Help Groups;
(i) Loans to distressed farmers indebted to non-institutional lenders;
(j) Loans to distressed persons other than farmers not exceeding Rs 1 Lakh per borrower to prepay their debt to non-institutional lenders;
(k) Loans to individual women beneficiaries up to Rs 1 Lakh per borrower. (L) also called or known as priority sector advancement (PSA);
(l) Account holders under Pradhan Mantri Jan Dhan Yojana (PMJDY)

8.15. ACTIVITIES UNDER PRIORITY SECTOR LENDING

The activities covered under priority sector lending are as follows:

1. AGRICULTURE:

The lending to the agriculture sector includes Farm Credit (Agriculture and Allied Activities), lending for Agriculture Infrastructure and Ancillary Activities.

Farm Credit to Individual farmers including Self Help Groups (SHGs) or Joint Liability Groups (JLGs) includes groups of individual farmers and Proprietorship firms of farmers, directly engaged in Agriculture and Allied Activities, such as dairy, fishery, animal husbandry, poultry, bee-keeping and sericulture.

Crop loans include loans for traditional/non-traditional plantations, horticulture and allied activities.

Medium and long-term loans for agriculture and allied activities such as the purchase of agricultural implements and machinery and developmental loans for allied activities.

Loans for pre and post-harvest activities viz. spraying, harvesting, grading and transporting their own farm produce.

Loans to distressed farmers indebted to non-institutional lenders.

Loans under the Kisan Credit Card Scheme.

Loans to small and marginal farmers for the purchase of land for agricultural purposes.

Loans against pledge/hypothecation of agricultural produce (including warehouse receipts) for a period not exceeding 12 months.

The limit is fixed up to Rs.75 lakh against Negotiable Warehouse Receipts and up to Rs. 50 lakh against warehouse receipts not coming under the above category.

Loans to farmers for installation of stand-alone Solar Agriculture Pumps and solarisation of grid-connected Agriculture Pumps.

2. AGRICULTURE INFRASTRUCTURE:

Loans for construction of storage facilities (warehouses, market yards, godowns and silos) including the storage units/ cold storage chains designed to store agricultural produce/products, irrespective of their location.

Soil conservation and watershed development.

Plant tissue culture and agri-biotechnology, seed production, production of bio-pesticides, bio-fertilizer, and vermicomposting.

For the above, the aggregate sanctioned limit of credit is Rs 100 crore per borrower from the banking system.

3. ANCILLARY ACTIVITIES:

Loans up to Rs 5 crore to co-operative societies of farmers for disposing of the produce of members.

Loans for setting up of Agriclinics and Agribusiness Centers.

Loans for Food and Agro-processing up to an aggregate sanctioned limit of Rs 100 crore per borrower from the banking system.

Bank loans to Primary Agricultural Credit Societies (PACS), Farmers' Service Societies (FSS) and Large-sized Adivasi Multi-Purpose Societies (LAMPS) for on-lending to agriculture.

Other eligible funds are with NABARD if a priority sector shortfall is noticed.

4. SMALL AND MARGINAL FARMERS:

Farmers with land holdings of up to 1 hectare come under the Marginal Farmer category.

Farmers with a landholding of more than 1 hectare and up to 2 hectares are considered Small Farmers.

Landless agricultural labourers, tenant farmers, oral lessees and share-croppers.

Loans to Self Help Groups, where groups of individual Small and Marginal farmers are directly engaged in Agriculture and Allied Activities.

Banks have to maintain disaggregated data of such loans.

Loans to farmers' producer companies of individual farmers, and co-operatives of farmers directly engaged in Agriculture and Allied Activities.

In this case, the membership of Small and Marginal Farmers is not less than 75 per cent and their land-holding share should not be less than 75 per cent of the total land-holding.

5. MICRO, SMALL AND MEDIUM ENTERPRISES (MSMEs):

Micro enterprises are the ones where the investment in plant and machinery or equipment does not exceed one crore rupees and turnover does not exceed five crore rupees.

Small enterprises are the ones where the investment in plant and machinery or equipment does not exceed ten crore rupees and turnover does not exceed fifty crore rupees.

Medium enterprise, where the investment in plant and machinery or equipment does not exceed fifty crore rupees and turnover does not exceed two hundred and fifty crore rupees

Bank loans to Micro, Small and Medium Enterprises, for both manufacturing and service sectors are eligible to be classified under the priority sector as per the following-

Manufacturing Enterprises

Micro, Small and Medium Enterprises engaged in the manufacture or production of goods to any industry specified in the first schedule of the Industries (Development and Regulation) Act, 1951.

They are notified by the Government from time to time, such industries are defined in terms of investment in plant and machinery.

Service Enterprises

Bank loans up to Rs 5 crore per unit to Micro and Small Enterprises and Rs 10 crore to Medium Enterprises engaged in providing or rendering services.

They are defined in terms of investment in equipment under the MSME Development Act, 2006.

Khadi and Village Industries Sector

All loans to units in this sector are eligible for classification under the sub-target of 7.5 per cent prescribed for Micro Enterprises under the priority sector.

6. EDUCATION:

Loans to individuals for educational purposes, including vocational courses, not exceeding Rs 20 lakh are considered eligible for priority sector classification.

Loans currently classified as a priority sector would continue till maturity.

7. **HOUSING:**

Loans to individuals up to Rs 35 lakh in metropolitan centres.

Up to Rs 25 lakh in other areas apart from Urban centres for purchase/construction of a dwelling unit per family.

The overall cost of the dwelling unit in the metropolitan centre and at other centres should not exceed Rs 45 lakh and Rs 30 lakh respectively.

The housing loans to banks' employees are excluded.

Loans up to Rs10 lakh in metropolitan centres and up to Rs 6 lakh in other centres for repairs to damaged dwelling units conforming to the overall cost of the dwelling unit.

Bank loans to any governmental agency for construction of dwelling units or slum clearance and rehabilitation of slum dwellers subject to dwelling units with a carpet area of not more than 60 sq.m.

8. **SOCIAL INFRASTRUCTURE:**

Loans up to a limit of Rs 5 crore per borrower for setting up schools, drinking water facilities and sanitation facilities.

It includes the construction/ refurbishment of household toilets and water improvements at the household level.

Loans up to a limit of Rs 10 crore per borrower for building health care facilities including under Ayushman Bharat in Tier-2 to Tier-6 centres

In the case of UCBs, the above limits are applicable only in centres having a population of less than one lakh.

Bank credit to Micro Finance Institutions (MFI) extended for on-lending to individuals/ members of SHGs/ JLGs for water and sanitation facilities are also eligible under these categories, subject to certain criteria.

9. **RENEWABLE ENERGY:**

Loans up to Rs 30 crore to borrowers for purposes such as solar-based power generators, biomass-based power generators, windmills, and micro-hydel plants.

Non-conventional renewable energy-based public utilities like street lighting systems and remote village electrification.

For individual households, the loan limit is Rs 10 lakh

10. **OTHERS:**

Loans not exceeding Rs 1.00 lakh per borrower are provided directly by banks to individuals and individual members of SHGs when they fulfil certain criteria of annual income.

Loans not exceeding Rs 2.00 lakh are provided directly by banks to SHG for activities other than agriculture or MSME, such as meeting social needs, construction or repair of houses, construction of toilets or any viable common activity started by the SHGs.

Loans to distressed persons not exceeding Rs 1,00,000/- per borrower to prepay their debt to non-institutional lenders.

Loans sanctioned to State Sponsored Organizations for Scheduled Castes/ Scheduled Tribes for the specific purpose of purchase and supply of inputs and/or the marketing of the outputs of the beneficiaries of these organizations

8.16. SUMMARY

Priority sector lending has enabled many to avail the facilities of institutional credit, which is otherwise difficult provided the exploitative non-institutional credit sources farmers

and share crop growers usually resort to as a last option. It has also given impetus to the growth of small and micro enterprises, creating more enterprises, and promoting entrepreneurship. However, there are some apprehensions as to whether loans to certain domains can create NPAs for the banks. The dichotomy of reliable credit and cases translating to NPAs should be addressed. Genuine enterprises in need of credit should not suffer.

Further, there exist expert views as to how converting some part of priority sector lending to a grant paid directly by the government can unlock large amounts of efficiency in the system. It is believed to dramatically increase the valuation of public sector banks, and be of immense help to weaker segments, in need of institutional credits. All stakeholders must come forward to evolve a mechanism to reduce the NPA contribution from potential sectors. Moreover, it will ensure the necessary institutional credit facilities to various ventures, enterprises, farmers, and other similar groups, providing them breathing space to shape their dreams, growth and livelihood.

8.17 KEY WORDS

Loan - A loan is a sum of money that one or more individuals or companies borrow from banks or other financial institutions so as to financially manage planned or unplanned events.

Mortgage Loan - A mortgage is a type of loan used to purchase or maintain a home, plot of land, or other types of real estate. The borrower agrees to pay the lender over time, typically in a series of regular payments that are divided into principal and interest. The property then serves as collateral to secure the loan.

Secured loan - A secured loan is one that is backed by some form of collateral. Some common attributes of secured loans include lower interest rates, strict borrowing limits, and long repayment periods.

Unsecured loan - 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.

Open ended loans - An individual has the freedom to borrow over and over. Credit cards and lines of credits are perfect examples of open-ended loans.

Close ended 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.

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).

8.18SELF ASSESSMENT QUESTIONS:

I. ESSAY TYPE QUESTIONS:

1. Briefly explain about principles of lending?
2. Explain about different types of loans?

3. Define mortgage loan and types of mortgage loan?
4. Elucidate about priority sector lending and its types?

II. SHORT TYPE QUESTIONS:

1. Types of loans.
2. Mortgage Loan.
3. Priority Sector Lending.

8.19 SUGGESTED READINGS

1. G. Shoba (2016) "An Analysis on The Lending Practices with Special Reference To Cooperative Bank, Vaniyambadi Branch". International Journal of Innovative Research in Management Studies, Issn: 2455-7188, Volume 1, Issue 5.
2. Sharma, P.K. and Chaudhary, A.K. (2058 B.S.). Statistical Methods. Kathmandu: Khanal Books Prakashan.
3. Shekhar, K.C. and Shekhar, L. (2000). Banking Theory and Practices (18th ed). New Delhi: Vikas Publishing House Pvt. Ltd.
4. Tamrakar, D. (2007). Study on Loan and Advances of Commercial Banks (With special reference to Nepal Investment Bank Ltd., Everest Bank Ltd. and Nepal Industrial and Commercial Bank Ltd.). An Unpublished Master’s Thesis, Submitted to Faculty of Management, Tribhuvan University.

Dr. Shaik Ameer

LESSON - 9
e-BANKING

Aims and Objectives:

After reading this lesson the student would know:

- E-banking and its features.
- How a credit and debit card can be used.
- Net banking and its features
- Advantages and disadvantages of net banking.
- What is digital currency and mobile banking.

STRUCTURE

9.1. Introduction
9.2. Features of E-Banking
9.3. Debit Card
9.4. How A Debit Card Works
9.5. Debit Card Fees
9.6. Credit Card
9.7 Meaning of Credit Card
9.8. Types of Credit Cards
9.9. Net Banking
9.10. Features of Online Banking
9.11. Advantages of Internet Banking
9.12. Disadvantages of Internet Banking
9.13. Mobile Banking
9.14. Micro ATM's
9.15. Digital Currency
9.16. Core Banking Solutions
9.17. Advantages of Core Banking
9.18. Advantages For Businesses
9.19. Summary
9.20 Key Words
9.21. Self-Assessment Questions
9.22. Suggested Readings

9.1. INTRODUCTION

Online banking, also known as internet banking, e-banking or virtual banking, is an electronic payment system that enables customers of a bank or other financial institution to conduct a range of financial transactions through the financial institution's website. The online banking system will typically connect to or be part of the core banking system operated by a bank and is in contrast to branch banking which was the traditional way customers accessed banking services. Fundamentally and in mechanism, online banking, internet banking and e-banking are the same thing. To access a financial institution's online banking facility, a

customer with internet access would need to register with the institution for the service, and set up a password and other credentials for customer verification. The credentials for online banking are normally not the same as for telephone or mobile banking. Financial institutions now routinely allocate customers numbers, whether or not customers have indicated an intention to access their online banking facility. Customers' numbers are normally not the same as account numbers, because a number of customer accounts can be linked to the one customer number. The customer number can be linked to any account that the customer controls, such as cheque, savings, loan, credit card and other accounts. The customer visits the financial institution's secure website, and enters the online banking facility using the customer number and credentials previously set up. The types of financial transactions which a customer may transact through online banking usually includes obtaining account balances, lists of the latest transactions, electronic bill payments and funds transfers between a customer's or another's accounts.

A number of authors and experts have defined e-banking services as a contemporary facility that provides conventional bank products and services through a new medium i.e. IT. It is entirely automated facility based on IT delivery mechanism to conventional banking users' products and services. It provides online medium of conducting and providing various banking services, such as, online accessibility of bank account, online fund transfer facility, online bills paying facility etc. The benefits provided by e-banking medium have resulted into swift growth of banking sector worldwide. The internet facility has transformed the business world in terms of managing business. According to Abu Shahab et al. (2010), internet has transformed the entire business pattern for people as well as for businesses. Although, technological advancements are happening everyday but not every advancement has been welcomed and adapted by financial sector; but financial sector that enjoying advantages of this new mode of service delivery, has adapted the e-banking phenomenon from its introduction only. Originally it was used for online banking promotional activities of their products and services; but as the e-banking concept developed, banks have started enjoying its various other advantages, such as, reduced per transaction cost, enhanced customer service, raised long term returns by providing 'anytime anywhere' banking to the banking customers. Advancement in technology provides fast innovative changes in people's routine life. The most significant recent technical advancement that drastically transformed the entire scenario of providing services is the use of internet facility in service delivery. Number of people that are adapted this technological advancement for online transaction such as, online shopping, is increasing tremendously. Gradually, more business organizations realized that it can be utilized to facilitate growth through its advantages of easy accessibility to information and technology transfer. The cut throat competitive environment and demanding customers compelled banks to adapt e- banking concept.

Most of the business organizations have swiftly adapting the advancement in technology and internet facility. Adopting new internet applications have resulted in enhancement of efficiency and quality of service provided as well as attracting prospecting customers. Thus, evolution of internet facility had transformed entire business world around the globe and same happened in banking sector. Banking sector have always been on the top in using ICT in banking business. Challenges faced by banking sector such as, increase in competition, catering variety of demand of heterogeneous customers, decreasing revenue margin and advantages provided by technology, have compelled banks to process new human resource management system. To successfully face all these challenges banks have adapted new technological advancements as earliest as possible. Other driving forces that worked for banks to adapt technological advancements are the challenges of meeting varied customer

expectations, new regulation and entering into new geographical areas and requirement of new products and services. Technological advancement specifically, in IT is always seen as the main source of changes taking place around the globe. The entire banking industry has entered into an unparalleled Competitive form facilitated by new ICT infrastructure, because of universal and gradual development of ICT.

9.2. FEATURES OF E-BANKING:

1. **FASTER TRANSATIONS**: E-banking provides the facility of instant transfer of funds to its customers. It saves the time of customers as funds get transferred very fast from one account to another. Whole system of E-banking is automated & works over the internet. People don't need to wait in queue to transfer their funds or pay off their bills; they can easily do it through their device. It saves the time of customers as they can easily access their account with the help of their device.

2. **LOWERS TRANSATION COST**: E-Banking reduces the cost involved in doing financial transactions. Electronic transactions are termed as the cheapest medium of doing transactions. It has reduced the manpower requirements as workload is reduced. Whole transactions are done online over the internet. It has also reduced the paperwork in organisations as all transactions are recorded digitally. There is no need to manually enter & store each record.

3. **PROVIDES 24X7 SERVICE:** This is the most important feature of E-banking. E-Banking provides customers with all-time access facility to their accounts. Customers can easily access their account anytime & from anywhere with no limitations. It provides convenience to the customers as they can perform transactions as per their wish.

4. **REDUCES THE CHANCES OF ERROR:** E-banking has reduced the chance of human error. It has reduced the role of the human in the whole transaction process. E-banking system works fully automated over the internet. All transactions are recorded & stored digitally. There is no need to manually maintain each & every record in books

5. **DEVELOPS LOYALTY IN CUSTOMERS**: E-banking helps the banks to develop large number of loyal customers. Through E-banking service banks are able to serve their customers well. They are able to provide fast & better service to customer. Customers are able to get a user-friendly interface from the banking website. They are able to avail services any time even from their home comfort. This develops a sense of loyalty among customers when they are happy with the services of their banks.

6. **REMOVES EOGRAPHICAL BARRIES**: E-Banking has removed all distance barriers for performing transactions. It has removed all distance barriers that customers used to face in the traditional method of performing transactions. E-banking provides the facility of instant transfer of funds both nationally & internationally. All systems are connected to each other online which facilitate easy transfer of funds.

7. **PROVIDES BETTER PRODUCTIVITY:** It has an efficient role in increasing the productivity of the businesses. Whole financial transaction system is supported by automated software systems. These systems are specially designed for doing transactions of funds. It reduces the time required for doing transactions & also reduces

the workload of business organisations. Everything is stored digitally & they don't need to store anything manually. It increases the overall productivity of the businesses.

8. **REDUCE FRAUDS IN TRANSACTIONS:** Another important feature of e-banking is that it helps in continuously monitoring of accounts. You can easily track each & every transaction of your accounts. You can easily track if any fraud is done by anyone in financial transactions. It provides a complete digital footprint of all those who can modify your banking activities & commit fraud. It thereby adds transparency to your accounts which reduces the overall chances of fraud.

9.3. DEBIT CARD

A debit card is a payment card that deducts money directly from your checking account. Also called "check cards" or "bank cards," debit cards can be used to buy goods or services or to get cash from an ATM. Debit card can help you reduce the need to carry cash, although using these cards can sometimes entail fees.

9.4. HOW A DEBIT CARD WORKS

A debit card is a card linked to your checking account. It looks like a credit card, but it works differently. The amount of money you can spend on a debit card is determined by the amount of funds in your account, not by a credit limit such as credit cards carry. Your debit card may be connected electronically to your account, or it can be an offline card. Offline cards take longer to process transactions. Unlike with a credit card, you do not go into debt when you use a debit card because you are using it to access funds you already have. You do not have to make monthly minimum payments on a debit card because there is no debt to repay.

You can use a debit card to get cash from an ATM, or you can make purchases with it like you make purchases with credit cards. With debit cards, you may need to enter your PIN (personal identification number), although many debit cards can be used to make purchases without a PIN.

Debit cards draw the funds immediately from the affiliated account. So, your spending is limited to what's available in your checking account, and the exact amount of money you have to spend will fluctuate along with your account balance. *Debit cards usually have daily purchase limits, meaning you can't spend more than a certain amount in one 24-hour period.*

9.5. DEBIT CARD FEES:

Generally, debit cards do not have annual membership fees or cash-advance charges, but there are other potential fees to consider.

1. **ATM TRANSACTION FEE**: If you withdraw cash from an ATM that's not affiliated with the bank that issued your debit card, you may be charged an ATM transaction fee. These fees are also called "out-of-network" fees.
2. **INSUFFICIENT FUNDS FEE**: If you use the card to spend more than you have in your account, you can face an insufficient funds charge. These fees are also called non-sufficient funds (NSF) fees.
3. **OVERDRAFT FEE**: If you've registered for overdraft protection and spend more than your limit, your purchase will go through, but you will incur overdraft fees.
4. **REPLACEMENT CARD FEE**: You might incur a replacement card fee if your debit card is lost, damaged, or stolen and you need to order a new card.
5. **FOREIGN TRANSACTION FEE**: If you use your debit card to make a purchase in a foreign currency, you could get charged a foreign transaction fee, such as 3% on the

transaction amount. A prepaid debit card, which has a set amount of money stored on it, may have similar fees. A prepaid debit card is like a gift card in that it allows you to spend a sum that's been loaded onto the card. Fees for prepaid debit cards can include monthly maintenance fees, transaction fees, ATM fees, reloading fees, balance inquiry fees, inactivity fees, paper statement fees, and foreign transaction fees.

9.6. CREDIT CARD

Credit cards impose the condition that cardholders pay back the borrowed money, plus any applicable interest, as well as any additional agreed-upon charges, either in full by the billing date or over time.

In addition to the standard credit line, the credit card issuer may also grant a separate cash line of credit (LOC) to cardholders, enabling them to borrow money in the form of cash advances that can be accessed through bank tellers, ATMs, or credit card convenience checks. Such cash advances typically have different terms, such as no grace period and higher interest rates, compared with those transactions that access the main credit line. Issuers customarily preset borrowing limits based on an individual's credit rating. A vast majority of businesses let the customer make purchases with credit cards, which remain one of today's most popular payment methodologies for buying consumer goods and services.

9.7 MEANING OF CREDIT CARD

Credit cards typically charge a higher annual percentage rate (APR) vs. other forms of consumer loans. Interest charges on any unpaid balances charged to the card are typically imposed approximately one month after a purchase is made (except in cases where there is a 0% APR introductory offer in place for an initial period of time after account opening), unless previous unpaid balances had been carried forward from a previous month—in which case there is no grace period granted for new charges. By law, credit card issuers must offer a grace period of at least 21 days before interest on purchases can begin to accrue. That's why paying off balances before the grace period expires is a good practice when possible. It is also important to understand whether your issuer accrues interest daily or monthly, as the former translates into higher interest charges for as long as the balance is not paid. This is especially important to know if you're looking to transfer your credit card balance to a card with a lower interest rate. Mistakenly switching from a monthly accrual card to a daily one may potentially nullify the savings from a lower rate.

9.8. TYPES OF CREDIT CARDS

Here are some detailed overviews about Credit Cards types available-

1. **CONTACTLESS CREDIT CARDS:** Contactless credit cards feature a proprietary payment technology that enables cardholders to make payments by simply tapping their cards at POS terminals. Customers do not need to enter a PIN number to make purchases using contactless transactions, which are extremely secure. These cards provide a variety of benefits such as discounts, cash back, entertainment benefits, reward points, a welcome gift, lounge access, concierge service, insurance coverage, and so on.
2. **WOMEN'S CREDIT CARDS:** Some banks have introduced credit cards specifically designed for women to ensure that their female customers receive the most benefits.

Women's credit cards are primarily concerned with shopping rewards and cash back offers. Cardholders can receive bonus reward points, a waiver of fuel surcharges, insurance, and other benefits. They can also earn reward points when they use their credit cards to make purchases.

3. **TRAVEL CARDS:** Travel credit cards are popular due to the numerous travels benefits they provide. These cards provide travel benefits not only in India but also abroad. Most banks have tied up with airline companies or travel companies to offer travel credit cards. Customers who use travel credit card to make travel purchases can earn air miles. Aside from that, some travel cards grant customers access to airport lounges Customers can convert the reward points they earn on these cards into air miles, which can then be used to book flights and upgrade seats. Travel cards also include hotel and vacation packages, golf packages, dining packages, travel insurance, and other benefits.
4. **CASHBACK CARDS**: Customers who use cashback credit cards receive cashback on their transactions that range from 5% to up to 20%, depending on the spend category. Cashback can be earned on bill payments, movie ticket purchases, retail purchases, dining bills, and grocery purchases, among other things Fuel surcharge waivers, annual fee refunds, dining and shopping privileges, global acceptance, rewards programs, balance transfers, and other benefits are available with every cashback card.
5. **CO-BRAND CARDS:** Banks offer co-branded credit cards in collaboration with a retail brand, travel aggregator, or any other financial institution. Both parties' benefits are integrated into a co-branded credit card, allowing customers to enjoy double benefits with a single card. Co-branded credit cards that are issued in conjunction with retail merchants are the most successful because banks can easily expand their customer base through the merchant's clientele. Co-branded credit cards may include benefits such as rebates, discounts, and offers from a retail partner brand, sporting benefits from a sports league, ticket booking privileges from airline and railway partners, holiday and hotel accommodation privileges from travel aggregators and premier hotel chains, and so on, depending on the tie-up.
6. **REWARD CARDS:** Rewards credit cards are well-known for providing multiple rewards with each card transaction. Cardholders can earn rewards points on all of their card transactions, including retail, online, and so on. In addition, they can earn reward points as a welcome gift, birthday gift, renewal bonus, and so on. Cardholders can earn points by spending a certain amount in a particular amount of time. These reward points can be redeemed for products/services listed in the rewards catalog, such as cashback deals, air miles, travel deals, and so on. Some credit cards allow cardholders to pay for purchases in instalments.
7. **BUSINESS CARDS:** Business credit cards are provided to businesses, corporations, and other financial institutions so that employers can provide credit cards to their employees while also conveniently managing their finances on the card. Employees cannot use these cards for personal transactions, and they are only valid during their employment with the company. Corporate cards provide benefits such as hotel and travel discounts, business savings plans, expense management, insurance, fuel surcharge waivers, airport lounge access, rewards programs, cash advances, add-on cards, bill payments, and the ability to convert purchases into monthly instillments. Companies can also choose to have their company name embossed on these credit cards.
8. **LIFESTYLE CARDS:** Lifestyle credit cards are designed with the applicants' changing lifestyles and income in mind. Most lifestyle credit cards include golfing, shopping, dining, travel, and other benefits. These cards typically include first-year

annual fee waivers, cashback on tickets, insurance discounts, and other perks. Customers who use lifestyle credit cards can earn bonus and accelerated rewards points on their purchases. The majority of these cards are Platinum credit cards that provide superior travel, shopping, dining, and luxury lifestyle benefits.

9. **PREMIUM CARDS:** Most banks provide a "Premium" or "Signature" credit card with the best lifestyle benefits. Flexible spending limits, premium airport lounge access, concierge services, complimentary insurance, rewards program, global assistance services, chartered yacht and flight services, surcharge waivers, retail, travel, and hotel accommodation vouchers, and so on distinguish premium credit cards. There are more options for reclaiming rewards earned with these cards.
10. **PREPAID CARDS:** Prepaid credit cards allow cardholders to load money into them and use that money to make purchases. Even though these cards do not provide a line of credit, customers can enjoy the majority of the benefits offered by other types of credit cards. The outstanding balance is the amount that the customer leaves on the prepaid card after completing a transaction.
11. **SILVER CARDS:** Silver credit cards are available to anyone who earns a low salary and has 4 to 5 years of work experience. Salaried employees can easily obtain this type of credit card if they have a good credit history. These cards have a low membership fee and no interest on the balance transfers for the first 6 to 9 months.
12. **GOLD CARDS**: Individuals with a higher income can apply for a gold credit card from any Indian bank. Any applicant for a gold credit card should have a good credit score.
13. **CLASSIC CARDS:** Classic credit cards include features such as global acceptance, revolving credit, cash advances, interest-free credit periods, rewards programs, supplementary cards, insurance, and a dedicated 24/7 customer care help desk. Most traditional credit cards have no annual or joining fees and have low finance charges.
14. **TITANIUM CARDS**: Titanium credit cards are high-end cards that come with a slew of perks and benefits. The Titanium Rewards program, which is available to customers, is the most important feature of a Titanium credit card. This rewards program includes the accumulation of reward points, the redemption of gifts and air miles, cashback offers, and so on. Surcharge waivers, revolving credit, interest-free credit period, annual fee reversals, insurance, welcome gifts in the form of vouchers from top retail brands, add-on card facility, wellness and beauty offer, lifestyle and dining benefits, and so on are all included with any Titanium credit card.
15. **PLATINUM CARDS:** Because of the numerous benefits and privileges it provides, the platinum card is one of the most popular credit cards and is held by a large number of people. The advantages include lifestyle, dining, shopping, and entertainment offers, among others. Platinum cards have slightly higher annual, joining, and renewal fees than other types of credit cards.

9.9. NET BANKING:

Internet banking, also known as online banking or e-banking or Net Banking is a facility offered by banks and financial institutions that allow customers to use banking services over the internet. Customers need not visit their bank’s branch office to avail each and every small service. Not all account holders get access to internet banking. If you would like to use internet banking services, you must register for the facility while opening the account or later. You have to use the registered customer ID and password to log into your internet banking account.

9.10. FEATURES OF ONLINE BANKING:

- Check the account statement online.
- Open a fixed deposit account.
- Pay utility bills such as water bill and electricity bill.
- Make merchant payments.
- Transfer funds.
- Order for a cheque book.
- Buy general insurance.
- Recharge prepaid mobile/DTH.

9.11. ADVANTAGES OF INTERNET BANKING

The advantages of internet banking are as follows:

1. **AVAILABILITY:** You can avail the banking services round the clock throughout the year. Most of the services offered are not time-restricted; you can check your account balance at any time and transfer funds without having to wait for the bank to open.
2. **EASY TO OPERATE:** Using the services offered by online banking is simple and easy. Many find transacting online a lot easier than visiting the branch for the same.
3. **CONVENIENCE:** You need not leave your chores behind and go stand in a queue at the bank branch. You can complete your transactions from wherever you are. Pay utility bills, recurring deposit account instalments, and others using online banking.
4. **TIME EFFICIENT:** You can complete any transaction in a matter of a few minutes via internet banking. Funds can be transferred to any account within the country or open a fixed deposit account within no time on net banking.
5. **ACTIVITY TRACKING:** When you make a transaction at the bank branch, you will receive an acknowledgement receipt. There are possibilities of you losing it. In contrast, all the transactions you perform on a bank's internet banking portal will be recorded. You can show this as proof of the transaction if need be. Details such as the payee's name, bank account number, the amount paid, the date and time of payment, and remarks if any will be recorded as well.

9.12. DISADVENTAGES OF INTERNET BANKING

The disadvantages of internet banking are as follows:

1. **INTERNET REQUIREMENT:** An uninterrupted internet connection is a foremost requirement to use internet banking services. If you do not have access to the internet, you cannot make use of any facilities offered online. Similarly, if the bank servers are down due to any technical issues on their part, you cannot access net banking services.
2. **TRANSACTION DECURITY: No** matter how much precautions banks take to provide a secure network; online banking transactions are still susceptible to hackers. Irrespective of the advanced encryption methods used to keep user data safe, there have been cases where the transaction data is compromised. This may cause a major threat such as using the data illegally for the hacker's benefit.
3. **DIFFICULT FOR BEGINNERS:** There are people in India who have been living lives far away from the web of the internet. It might seem a whole new deal for them to understand how internet banking works. Worse still, if there is nobody who can explain them on how internet banking works and the process flow of how to go about it. It will be very difficult for inexperienced beginners to figure it out for themselves.

4. **SECURING PASSWORGD**: Every internet banking account requires the password to be entered in order to access the services. Therefore, the password plays a key role in maintaining integrity. If the password is revealed to others, they may utilise the information to devise some fraud. Also, the chosen password must comply with the rules stated by the banks. Individuals must change the password frequently to avoid password theft which can be a hassle to remember by the account holder himself.

9.13. MOBILE BANKING

Mobile banking is a service provided by a bank or other financial institution that allows its customers to conduct financial transactions remotely using a mobile device such as a smartphone or tablet. Unlike the related internet banking it uses software, usually called an app, provided by the financial institution for the purpose. Mobile banking is usually available on a 24-hour basis. Some financial institutions have restrictions on which accounts may be accessed through mobile banking, as well as a limit on the amount that can be transacted. Mobile banking is dependent on the availability of an internet or data connection to the mobile device.

Transactions through mobile banking depend on the features of the mobile banking app provided and typically includes obtaining account balances and lists of latest transactions, electronic bill payments, remote check deposits, P2P payments, and funds transfers between a customer's or another's accounts Some apps also enable copies of statements to be downloaded and sometimes printed at the customer's premises. Using a mobile banking app increases ease of use, speed, flexibility and also improves security because it integrates with the user built-in mobile device security mechanisms From the bank's point of view, mobile banking reduces the cost of handling transactions by reducing the need for customers to visit a bank branch for non-cash withdrawal and deposit transactions. Mobile banking does not handle transactions involving cash, and a customer needs to visit an ATM or bank branch for cash withdrawals or deposits. Many apps now have a remote deposit option; using the device's camera to digitally transmit cheques to their financial institution. Mobile banking differs from mobile payments, which involves the use of a mobile device to pay for goods or services either at the point of sale or remotely,[2] analogously to the use of a debit or credit card to effect an EFTPOS payment.

9.14. MICRO ATM’s

Micro ATM meant to be a device that is used by a million Business Correspondents (BC) to deliver basic banking services. The platform will enable Business Correspondents (who could be a local kirana shop owner and will act as ‘micro ATM’) to conduct instant transactions. The micro platform will enable function through low cost devices (micro ATMs) that will be connected to banks across the country. This would enable a person to instantly deposit or withdraw funds regardless of the bank associated with a particular BC. This device will be based on a mobile phone connection and would be made available at every BC. Customers would just have to get their identity authenticated and withdraw or put money into their bank accounts. This money will come from the cash drawer of the BC. Essentially, BCs will act as bank for the customers and all they need to do is verify the authenticity of customer using customers’ UID. The basic transaction types, to be supported by micro ATM, are Deposit, Withdrawal, Fund transfer and Balance enquiry.

9.15. DIGITAL CURRENCY:

The Indian Government and the Reserve Bank of India have always been in favour of digital payments. They have supported the development of online payment platforms and also their widespread implementation. Now, the Government and RBI have taken a step further into the world of digital finance by launching digital currency. A digital rupee or central bank digital currency (CBDC) is a sovereign currency issued by central bank i.e., Reserve Bank of India.

Digital currency is an electronic form of money that anyone can use in contactless transactions. Nirmala Sitharaman, the Union Finance Minister, announced the launch of Central Bank Digital Currency (CBDC) in the 2022 Union Budget speech. She also stated the release of this new form of currency would help boost the digital economy and also make the currency management system cheaper and more efficient. According to RBI, the CBDC will be a sovereign currency available in a digital form. Just like normal currency issued by the central bank, CBDC will also appear as a liability on the balance sheet of the central bank. To put it simply, CBDC is a digital form of the Indian Rupee that you can exchange one-on-one with the fiat currency. Thus, they can be used for the consumer to consumer, consumer-to-business and business-to-business transactions with ease.

9.16. CORE BANKING SOLUTIONS

Core banking solution is an effective banking service that benefits customers in manifold ways. Robust transactions, improved document management, customer retention, and proper safety and compliance process are among the primary boons of core banking solutions. Core Banking Solution or CBS is required to streamline the banking process and cater to the dynamically fluctuating market.

Core banking is a centralised system that allows customers or business bodies to carry on business operations regardless of the bank's branch. The main objective of core banking solutions is to offer tailor-made offerings to customers at their convenience. These solutions differ in nature and are dependent a lot on the customer base. CBS refers to the networking of different bank branches that enables customers to opt for varied banking facilities from different corners of the world. The entire banking application is based on a centralised server and can be used via the internet. Different functions of core banking encompass transactions, payments, loans and more. Internet banking, ATMs (Automated Teller Machines), Phone banking, Fund transfer remotely and instantly (IMPS, NEFT, RTGS and more), interest computation on loans and deposits etc., are some of the core banking solutions types. While customers or business bodies reap the benefits of carrying out transactions freely, financial institutions via core banking solutions benefit from lesser time and can save upon resources that are used for repetitive business activities.

Some of the lucrative features of core banking solutions are:

- Transaction management
- Customer relationship management activities
- Accounts, loans and disbursal management
- Customer onboarding
- Deposits and withdrawal management etc.

9.17. ADVANTAGES OF CORE BANKING:

Both businesses and customers benefit from different core banking solutions.

- Internet banking, mobile banking etc. are among the multiple channels that prove effective for faster payment processing.
- CBS (Core Banking Solution) benefits those who are living in rural areas. For instance, farmers can easily get e-payments towards subsidies directly in their accounts.
- Customers can get expedited service for routine transactions which includes withdrawals, passbooks, demand drafts, cash deposits etc.
- The provision of a 24X7 banking service is another notable advantage of core banking solutions. Moreover, the provisions can be opted at anytime and anywhere.
- Every bank branch uses applications from the data centre or central servers, hence deposits done in one branch get displayed instantly. Customers or any business owners can withdraw funds from any branch across the world.
- Core banking solutions curb the need for filling out multiple entries, thereby reducing errors and ensuring accuracy.
- It facilitates a hassle-free merging of self-service operations and back-office data.

9.18. ADVANTAGES FOR BUSINESSES:

- Core banking solutions facilitate standardisation and transparency within business bodies and branches of banks. Since all the branches are connected to a central server, transactions can be viewed anytime. Instant projection of the transactions helps businesses to deal with inaccurate transactions or fraud.
- Core banking solution emerged to be a saviour helping businesses cater to the increasing needs of customers. It ensures better customer retention via prompt customer service.
- This banking mode has led to the minimization of errors, thereby facilitating accurate transactions.
- It helps to bring down and manage operational costs involving lesser manpower for process execution.
- With the emergence of different core banking solution types, submission of reports to regulatory boards and the government has become convenient.
- Core banking solutions help in efficient documents and record management. CBS incorporates a centralized database that helps in the faster collection of data.
- It has become convenient for businesses to process cash, compute interest, open accounts, incorporate policy changes etc.
- In addition, businesses can offer services and products to customers at nominal rates. For instance, automating different parts of financial transactions has curbed the need for multiple staff, helping to save on wages and related costs.
- Custom-crafted banking software enables full integration of the banking system.
- Another advantage of core banking is that it adds security levels to the banking system.
- Core banking solutions facilitate informed decision-making ability. For instance, as the overall banking procedure has become streamlined, business bodies can now decide whether to use the funds for business expansion or for lending out to customers.

9.19. SUMMARY

Online banking, also known as internet banking, e-banking or virtual banking, is an electronic payment system that enables customers of a bank or other financial institution to conduct a range of financial transactions through the financial institution's website. Most of the business organizations have swiftly adapting the advancement in technology and internet facility. Adopting new internet applications have resulted in enhancement of efficiency and quality of service provided as well as attracting prospecting customers. E-banking provides the facility of instant transfer of funds to its customers. It saves the time of customers as funds get transferred very fast from one account to another. E-Banking reduces the cost involved in doing financial transactions. Electronic transactions are termed as the cheapest medium of doing transactions. This is the most important feature of E-banking. E-Banking provides customers with all-time access facility to their accounts. A debit card is a payment card that deducts money directly from your checking account. Also called “check cards” or "bank cards," debit cards can be used to buy goods or services or to get cash from an ATM. A credit card is a thin rectangular piece of plastic or metal issued by a bank or financial services company that allows cardholders to borrow funds with which to pay for goods and services with merchants that accept cards for payment. Internet banking, also known as online banking or e-banking or Net Banking is a facility offered by banks and financial institutions that allow customers to use banking services over the internet. Mobile banking is a service provided by a bank or other financial institution that allows its customers to conduct financial transactions remotely using a mobile device such as a smartphone or tablet. Unlike the related internet banking it uses software, usually called an app, provided by the financial institution for the purpose. The Indian Government and the Reserve Bank of India have always been in favour of digital payments. They have supported the development of online payment platforms and also their widespread implementation.

9.20. KEY WORDS

DEBIT CARD - A debit card is a payment card that deducts money directly from your checking account. Also called “check cards” or "bank cards," debit cards can be used to buy goods or services or to get cash from an ATM.

CREDIT CARD - A credit card is a thin rectangular piece of plastic or metal issued by a bank or financial services company that allows cardholders to borrow funds with which to pay for goods and services with merchants that accept cards for payment.

WOMEN’S CREDIT CARDS: Some banks have introduced credit cards specifically designed for women to ensure that their female customers receive the most benefits. Women's credit cards are primarily concerned with shopping rewards and cash back offers. Cardholders can receive bonus reward points, a waiver of fuel surcharges, insurance, and other benefits. They can also earn reward points when they use their credit cards to make purchases.

TRAVEL CARDS: Travel credit cards are popular due to the numerous travels benefits they provide. These cards provide travel benefits not only in India but also abroad. Most banks have tied up with airline companies or travel companies to offer travel credit cards. Customers who use travel credit card to make travel purchases can earn air miles.

BUSINESS CARDS: Business credit cards are provided to businesses, corporations, and other financial institutions so that employers can provide credit cards to their employees while also conveniently managing their finances on the card.

NET BANKING: Internet banking, also known as online banking or e-banking or Net Banking is a facility offered by banks and financial institutions that allow customers to use banking services over the internet. Customers need not visit their bank's branch office to avail each and every small service.

9.21 SELF ASSESSMENT QUESTIONS

I. ESSAY TYPE QUESTIONS:

1.What are the different types of E-Banking services?
2.What is the significance of E-Banking for customers?
3.How does E-Banking benefit businesses?
4.What are the advantages of E-Banking for banks?
5.Briefly explain about debit card?
6. Briefly explain about credit card?

II. SHORT TYPE QUESTIONS

1 .What is meant by mobile banking?
2. Define Micro ATM's?
3. Define Digital Currency?
4. What are the advantages of core banking solutions?

9.22. SUGGESTED READINGS

1. 1.Singh, Jaspreet, and Neena Brar. "internet banking need of current scenario." *international journal of management & information technology* 1, no. 2 (June 30, 2012): 67–72.
2. Ali Naghi Mansour Beigi. et.al. (2016) "The Study Of The Effects Of E-Banking Services Quality On Customers' Satisfaction And Loyalty (Case Study: Agricultural Bank Of Khuzestan Province)". Journal Of Current Research In Science, ISSN: 2322-5009, Vol S, Issue 1, Page No.: 375-381.
3. Mahmood Shah and Steve Clarke (2009) " E-Banking Management: Issues, Solutions, and Strategies. Chapter XI Strategy Development for E-Banking". Information Science Reference, ISBN 978-1-60566-252-7, Page No. 229-253.

Dr. Shaik Ameer

LESSON -10
CORRESPONDENT BANKING MODEL

Aims and Objectives:

After completing the unit, the student is able to perform the following:

- What do you mean by Correspondent bank
- What are the functions of correspondent bank?
- How a correspondent Bank works
- What are the activities of correspondent banks
- Risks, Challenges and Benefits of Correspondent bank
- Recent trends in correspondent banking

Structure

10.1 Introduction
10.2 Definitions
10.3 Activities of Correspondent Banks
10.4 How a Correspondent Bank Works
10.5 Correspondent Bank Relationship
10.6 Risks, Challenges and Benefits of Correspondent bank
10.7 Features of Correspondent bank
10.8 Need for the Correspondent banks
10.9 Recent developments in correspondent banking
10.10 Summary
10.11 Key words
10.12 Self-Assessment Questions
10.13 Suggested Readings

10.1 INTRODUCTION

A correspondent bank is a third-party financial institution that acts as a go-between for domestic and foreign banks that need to conduct cross-border payments with each other. It is an essential component of the global payment system, especially for cross border transactions. Through correspondent banking relationships, banks can access financial services in different jurisdictions and provide cross-border payment services to their customers, supporting, inter alia, international trade and financial inclusion. In addition, most payment solutions that do not involve a bank account at customer level (eg remittances) rely on correspondent banking for the actual transfer of funds. Until recently, banks have maintained a broad network of correspondent relationships, but there are growing indications that this situation might be changing. In particular, some banks providing these services are cutting back the number of relationships they maintain and are establishing few new ones.

A correspondent bank is a financial institution that provides services to another one—usually in another country. It acts as an intermediary or agent, facilitating wire transfers, conducting business transactions, accepting deposits, and gathering documents on behalf of another bank. Correspondent banks are most likely to be used by domestic banks to execute transactions that either originate or are completed in other countries. Domestic banks generally use correspondent banks to gain access to foreign financial markets and to serve international clients without having to open branches abroad. There are countless examples of correspondent banks around the world. Among the most well-known and largest correspondent banks are: JPMorgan Chase, Bank of America, Citibank, HSBC, Deutsche Bank, Standard Chartered Bank, Barclays, Wells Fargo, BNP Paribas.

Through there are correspondent banking relationships with other banks worldwide, these banks are able to provide a range of banking services to their customers worldwide. There are other banks that operate as correspondent banks, such as Asian, Middle Eastern, and Latin American regional banks that serve their local markets and provide correspondent banking services to banks elsewhere. While some transactions may have both a correspondent and a respondent bank, in others these functions can both be filled by the same institution

10.2 DEFINITIONS

Correspondent banking can be defined, in general terms as "an arrangement under which one bank (correspondent) holds deposits owned by other banks (respondents) and provides payment and other services to those respondent banks".

The ECB uses a similar basic definition in its correspondent banking survey, referring to "agreements or contractual relationships between banks to provide payment services for each other".

A more detailed definition by the Wolfsberg Group establishes that "correspondent Banking is the provision of a current or other liability account, and related services, to another financial institution, including affiliates, used for the execution of third-party payments and trade finance, as well as its own cash clearing, liquidity management and short-term borrowing or investment needs in a particular currency".

At the most basic level, correspondent banking requires the opening of accounts by respondent banks in the correspondent banks' books and the exchange of messages to settle transactions by crediting and debiting those accounts.

All these definitions highlight the main components of correspondent banking: a bilateral agreement between two banks by which one of them provides services to the other; the opening of accounts (by the respondent in the books of the correspondent) for the provision of services and the importance of payment services as a core function of correspondent banking. As the ECB definition highlights, these relationships are frequently reciprocal, in that each institution provides services to the other, normally in different currencies. Correspondent banking is especially important for cross-border transactions, as its importance for domestic payments within a single jurisdiction has diminished greatly due to the use of financial market

infrastructures. On a cross-border level, however, correspondent banking is essential for customer payments and for the access of banks themselves to foreign financial systems for services and products that may not be available in the banks' own jurisdictions.

10.3 ACTIVITIES OF CORRESPONDENT BANKS

- Identification of borrowers;
- Collection and preliminary processing of loan applications including verification of primary information/data;
- Creating awareness about savings and other products and education and advice on managing money and debt counseling;
- Processing and submission of applications to banks;
- Promoting, nurturing and monitoring of Self-Help Groups/ Joint Liability Groups/Credit Groups/others;
- Post-sanction monitoring;
- Follow-up for recovery,
- Disbursal of small value credit,
- Recovery of principal / collection of interest
- Collection of small value deposits
- Sale of micro insurance/ mutual fund products/ pension products/ other third party products and
- Receipt and delivery of small value remittances/ other payment instruments.

The major services provided by in exchange for correspondent bank charges include:

- Wire transfers
- Transaction settlements
- Trade finance
- Currency exchange
- Treasury services : Check clearing
- Managing Collecting documents internationally.

These institutions often transfer funds, and accounts handling the fund transfer are called Nostro and Vostro. The respondent mentions their account with the correspondent entity as Nostro (ours), and the correspondent entity says the account for a respondent entity with them as Vostro (Yours). One of the major networks used to expedite this system is the SWIFT network. SWIFT is one of the primary services focused on international remittances globally. The SWIFT network reveals relevant correspondent bank lists apt for accomplishing the transaction. However, countries such as China, India, and Russia are currently pushing forward new alternatives to SWIFT, which may diminish SWIFT's dominance over time.

10.4 HOW A CORRESPONDENT BANK WORKS

Correspondent banks are third-party banks. They act as middlemen between different financial institutions. As such, they provide treasury services between sending and receiving banks, especially those in different countries. Services can include:

- funds transfer
- settlement
- check clearing
- wire transfers
- currency exchange

Correspondent banks may also act as agents to process local transactions for clients when they are traveling abroad. At the local level, correspondent banks may accept deposits, process documentation, and serve as funds transfer agents.

The accounts held between correspondent banks and the banks for which they provide services are referred to as nostro and vostro accounts. An account held by one bank for another is referred to by the holding bank as a nostro account, or our account on your books. The same account is referred to as a vostro account—your account but on our books—by the counterparty bank. Generally speaking, both banks in a correspondent relationship hold accounts for one another for the purpose of tracking debits and credits between the parties.

Correspondent banks are a pivotal part of the financial industry, as they provide a way for domestic banks to operate when it isn't feasible for them to open branches in a different location—especially in another country.

For instance, a small domestic bank with clients in different countries can partner with a correspondent bank to meet the needs of its client internationally. Doing so also gives it access to the foreign financial market. The correspondent bank will, therefore, charge a fee for this service, which is usually passed off from the domestic bank to the customer.

Special Considerations

International wire transfers often occur between banks that don't have an established financial relationship. For example, a bank in San Francisco that receives instructions to wire funds to a bank in Japan can't wire funds directly without a working relationship with the receiving bank. Most international wire transfers are executed through the Society for Worldwide Interbank Financial Telecommunication (SWIFT) network. Knowing there isn't a working relationship with the destination bank, the originating bank can search the SWIFT network for a correspondent bank that has arrangements with both banks.

Upon finding a correspondent bank having arrangements with both sides of the transfer, the originating bank sends the transferred funds to its nostro account held at the correspondent bank. Using the example above, the correspondent bank deducts its transfer fee, usually between $0 and $50, and transfers the funds to the receiving bank in Japan. In transactions such as this, the correspondent bank adds value in two ways:

- It alleviates the need for the domestic bank to establish a physical presence abroad.

- It saves the work of setting up direct arrangements with other financial institutions around the world.

10.5 CORRESPONDENT BANK RELATIONSHIP

A correspondent banking relationship enables the respondent to shop for services from the correspondent entity. This effective cross-banking relationship allows the respondent to provide their clients with services requiring connection with a specific region where the respondent entity doesn't have a branch or presence and accomplish the need through local correspondent banks. This banking relationship benefit comes in many ways, such as:

- Increase in clients
- Increase in revenue
- Gain competitive advantage
- Reduce the cost of geographical extension of the banking organization

Using the service of a correspondent financial institution is far cheaper than opening branches in foreign countries. So, unless a bank is interested in starting operations there, outsourcing international payments or other banking services is a handy way not to lose their customers when they require international operations.

10.6 RISKS, CHALLENGES AND BENEFITS OF CORRESPONDENT BANK

The following are the risks, challenges and Benefits of Correspondent Banks

Risks of Correspondent Banking

Correspondent banking poses some risk-management challenges because the correspondent bank relies on its customer, the respondent bank, to perform Know Your Client (KYC) due diligence on its customers. Similarly, Reliance on a third party's compliance program—rather than conducting KYC on all customers for whom the respondent bank is processing payments through the correspondent bank—is why this activity is generally considered to be high-risk, from a money-laundering perspective.

Challenges in Correspondent Banking

- **Regulatory Compliance**: Adhering to the regulations of multiple countries can be complex.
- **Risk Management**: Ensuring that transactions are secure and free from fraudulent activities.
- **Operational Costs**: Maintaining these relationships can be costly, especially with multiple correspondent banks.

Benefits of Correspondent Banking

- **Global Reach**: Allows banks to operate internationally without establishing branches everywhere.
- **Diversified Services:** Offers a range of services, from trade finance to treasury operations.

- **Strengthened Relationships**: Builds trust and cooperation between international banking entities.

1.7 FEATURES OF CORRESPONDENT BANK

- The respondent bank is represented by a correspondent bank.
- The essential services provided by correspondent banks are treasuries, check clearing demand draft drawing, document processing, foreign exchange, finance, overseas investment management and much more.
- For the respondent bank's operations, the correspondent bank bills a set fee.
- Typically, international banking activities requiring currency exchange call for the operations of correspondent bank

Correspondent banking transactions generally follow a similar set of steps:

1. A respondent bank receives a request from a customer to execute a transaction in a foreign currency or foreign market.
2. The respondent bank does not have a presence or relationship in that market, so it contacts a correspondent bank that does.
3. The correspondent bank agrees to facilitate the transaction on behalf of the respondent bank and provides the necessary services, such as processing the payment or executing the trade.
4. The correspondent bank charges a fee for its services, usually paid by the respondent bank or passed on to the customer.
5. Once the transaction is completed, the correspondent bank informs the respondent bank of the outcome, and the funds are settled between the two banks.

Correspondent banking relationships are often subject to extensive regulatory oversight to mitigate risks such as money laundering or terrorist financing. The regulatory requirements may include conducting due diligence on each other, monitoring transactions for suspicious activity, and complying with local regulations.

10.8 NEED FOR THE CORRESPONDENT BANKS

International trade is hugely important in today's world. Nearly every single corporation and the person has global expansion aspirations for their operations. But this not feasible without banking facilities, similarly, it is impractical for each bank to establish a branch everywhere. Correspondent banking is helpful in the situation, for the respondent bank to offer banking facilities in foreign nations where it has no real presence, such banking facilities are necessary. When a branch in a particular nation is no financially possible, a foreign bank provides correspondent banks, as a result, the responding bank benefits from employing the facilities of correspondent banks.

There are many different situations in which a correspondent bank needs to be used. These situations include:

- **International payments**: If you need to make a payment in a foreign currency, and your bank does not offer that currency or does not have a presence in the beneficiary's country, a correspondent bank will be needed to facilitate the payment.
- **Trade finance**: If you are involved in international trade, a correspondent bank may need to provide trade finance services, such as issuing letters of credit or providing guarantees.
- **Foreign currency transactions**: If you need to convert funds to another currency and your bank does not offer that currency, a correspondent bank may be needed to provide the foreign currency.
- **Clearing services**: The process of settling financial transactions between two or more banks, typically involving the verification of the transaction and the transfer of funds.
- **Access to foreign markets**: A correspondent bank may be necessary if you want to expand your business in a foreign market.
- **Risk mitigation**: If you want to mitigate risks associated with international transactions, such as compliance with local regulations or managing settlement risks, a correspondent bank with a presence in that market may be required.

In summary, a correspondent bank is often required when your bank does not offer the necessary services or has a limited presence in a foreign market. Through the process of correspondent banking, your business may be able to gain access to a range of banking services in different markets that your bank alone may not be able to provide.

10.9 RECENT DEVELOPMENTS IN CORRESPONDENT BANKING

During the informal fact-finding carried out by the CPMI working group and the public consultation of the earlier version of this report, the following trends were identified:

- **Cutbacks in the number of relationships**: Correspondent banking relationships are being reduced in number, especially for respondent banks that (i) do not generate sufficient volumes to recover compliance costs; (ii) are located in jurisdictions perceived to be too risky; (iii) provide payment services to customers about which the necessary information for an adequate risk assessment is not available; or (iv) offer products or services or have customers that pose a higher risk for AML/CFT and therefore are more difficult to manage. As regards (iv), comments received during the public consultation argued that some decisions by correspondent banks to withdraw services to certain respondent banks are made following specific risk assessments of an individual respondent, which may include factors in addition to jurisdiction. This may suggest that some amount of de-risking may be occuring because banks are carrying out the requirements of the AML/CFT regime and thereby mitigating their exposure to AML/CFT risks that cannot be managed effectively.
- **Changes in relationships**: Those types of correspondent banking service that are perceived to have higher associated risks (nested correspondent banking, payable-through accounts) are being scaled back, so that traditional correspondent banking clearly predominates in the remaining relationships. These remaining relationships are often retained only to support the cross-selling of other products to respondent banks (ie the profit is made in other business areas and correspondent services are considered as a necessary ancillary service).

- **Concentration of relationships**: Cutbacks in the number of relationships as well as changes in their nature have resulted in a significant concentration of relationships in a relatively small number of service-providing institutions that increasingly dominate this market. In addition, a concentration of correspondent banking activities within affiliated banks was observed.
- **Difficulties in establishing or maintaining the correspondent banking relationships necessary for participation in financial market infrastructures (FMIs):** Banks that are members of multicurrency FMIs may employ a correspondent bank for cash settlements. Difficulties in establishing or maintaining correspondent banking relationships may make the maintenance of a backup correspondent relationship more burdensome. This is particularly relevant for multicurrency FMIs whose participants may need a number of correspondent banking relationships. For instance, CLS, a multicurrency FMI handling cross-border payments, reports that some participants have had difficulties in establishing alternative (backup) correspondent banking relationships.
- **Increasing costs**: The establishment and maintenance of a correspondent banking relationship are perceived to be increasingly costly both for correspondent and respondent banks.
- **Cutbacks to correspondent banking services in specific foreign currencies**: Some correspondent banks are increasingly reluctant to provide correspondent banking services in certain foreign currencies in which the perceived risk of economic sanctions, the regulatory burden related to AML/CFT or the uncertainties related to the implementation of these requirements and the potential reputational risk in case of non-compliance seem to be higher. There are indications that correspondent banking activities in US dollars are increasingly concentrated in US banks and that non-US banks are increasingly withdrawing from providing services in this currency except for some ancillary services. Simultaneously, the very same non-US correspondent banks might still be willing to provide correspondent banking services in their domestic currency.
- **Geographical imbalances**: Not all jurisdictions and currencies are affected equally. Respondent banks, in particular smaller banks located in jurisdictions perceived to be too risky, are especially affected by the reduction in the number of relationships.

In summary, increasing costs, regulatory requirements and an increased perception of risk are reducing the profit margins associated with this activity in some countries and/or with some customers and could be making this line of business increasingly unappealing to a growing number of correspondent banks. In particular, this is a business highly influenced by economies of scale, where banks are struggling to make returns when the business volumes in certain jurisdictions and/or with certain customers are not considered to justify the compliance costs involved. The perception is that this line of business has shifted from being a low-risk/low-margin segment to a high-risk/low-margin one.

10.10 SUMMARY

Correspondent banking services are an essential component of the global payment system, especially for cross-border transactions. There seems to be a variety of reasons for the general decline in correspondent banking relationships reported by many stakeholders. Often cited by correspondent banks as reasons for this decline are compliance with AML/CFT regulations, an increased perception of risk and some uncertainties on the potential impact of

non-compliance. The impact of this trend is uneven across jurisdictions and banks. Some correspondent banks specialise in the for-profit provision of correspondent banking services, and thus focus on respondent banks with business volumes that justify the rising costs. Others apparently maintain existing correspondent banking services only as far as these services support the cross-selling of other products. Some relationships are maintained or terminated according to the perceived degree of risk in the respondent bank's jurisdiction. As a result, some respondent banks might risk being cut off from the international payment networks. This trend implies a risk that cross-border payment systems will become fragmented, reducing the options available for these transactions.

10.11 KEY WORDS

1. **Correspondent Banking**: A financial institution known as a "correspondent bank" provides services to a client on account of another banking institution, typically located overseas. The correspondent bank provides a range of services to other banks, including document collection, receiving deposits, and much more. Correspondent banking is the term used to refer to this kind of group of banks. It is essential in assisting with international banking operations and business. In a correspondent banking agreement, one bank (the correspondent) maintains deposits in the account of another bank (the respondent bank). It provides the responding banks with payment and some other functions. The two banks have basically entered into a formal arrangement to offer payment solutions. It is to respondents bank customers who are physically present in correspondent bank territory.

2. **Treasury services** : Trade finance refers to the funds that help fill the payment gap created between the supply of the goods and the receipt of the same by customers. Offering such funds makes sure the movement of goods and services from one end to the other remains smooth and free of financial struggles.

3. **Need for CBM** : International trade is hugely important in today's world. Nearly every single corporation and the person has global expansion aspirations for their operations. But, this is not feasible without banking facilities. Similarly, it is impractical for each bank to establish a branch everywhere. Correspondent banking is helpful in this situation. For the respondent bank to offer banking facilities in foreign nations where it has no real presence, such banking facilities are necessary. When opening a branch in a particular nation is not financially possible, a foreign bank provides correspondent banks. As a result, the responding bank benefits from employing the facilities of correspondent banks.

4. **Managing international investments** : International Investments are those investments that are made outside the domestic markets and offer *portfolio diversification* and opportunities for risk minimization. An investor can make international investments, thereby broadening his portfolio and expanding his horizon of returns. International investments also serve as a means of adding different financial instruments to the list when domestic markets are confined and limited by their variety. International investments aim to assure investors of two probabilities; the counter of domestic market risks and the opportunities in foreign markets.

5. **SWIFT** : The full form of SWIFT is Society for Worldwide Interbank Financial Telecommunication. It is a platform that provides national financial institutions with a secure, standardized, and encrypted network in a reliable environment for the transfer of various important information, which can be from one financial institution to another branch or from one financial institution to another. It also provides software for maintaining various information.

10.12 SELF ASSESSMENT QUESTIONS

Essay Typed Questions:

1. Define Correspondent Banking? Explain How a correspondent bank works
2. What are the functions and features of a Correspondent Bank?
3. What are the recent developments in Correspondent Banking.

Short Answer Questions:

1. What do you mean by Correspondent Banking
2. Correspondent Bank Relationship
3. Risk, Challenges and benefits of Correspondent banking
4. Need for the Correspondent Banks

10.13 SUGGESTED READINGS

1. Uppal, R.K. 2007, & quot;Banking services and IT & quot; New century publications, New Delhi.
2. https://itidjournal.org/index.php/itid/article/download/242/242-578-2-PB.pdf
3. Anatolig G. Goncharuk (2012) “Banking Sector challenges in Research”
4. Dr. Krishna A. Goyal and Vijay Joshi (2014) “Indian Banking Industry: Challenges and Opportunities. International Journal of Business Research & Management, vol.3Issue1,18-28.
5. Dr. Lakshmi Bhai P.s. (2018) “E-banking in India – problems & prospects. International journal of Current Engineering and Scientific Research. Vol.5 Issue 1
6. Dr.K. Ratna Manikyam (2014) Indian Banking Sector – Challenges & Opportunities. International Journal Of Business & Management Vol.16 Issue 2,52-61. Niti Bhasin, 2007, "Banking development in India 1947 to 2007", Century publication, Delhi 110005.
7. Mithani, D. M. 2004. Money, Banking and Public Finance. First Edition, Himalaya Publishing House, Mumbai, p. 113.
8. Goyal, K.A. and Joshi, V. 2011. & quot;Mergers in banking industry of India: some emerging issues", Asian journal of business and management sciences, pp.157-165.

Dr.P.Venu Gopal

LESSON – 11
COMMON SERVICES CENTERS

Aims and Objectives:

After completing the lesson, the student is able to demonstrate the following:

- ✓ What do you mean by Common Service Centers?
- ✓ What are the objectives of CSCs
- ✓ Provisions of services by CSC
- ✓ Requirement for registering CSC
- ✓ Financial Inclusion through Common Services Centers (CSC) Scheme
- ✓ The concept of Tele Centre

Structure

11.1. Introduction
11.2. Objectives of CSC
11. 3. Services Provided by Common Service Centers (CSCs)
11.4 Requirements for registering CSC
11.5 How to Start a Common Service Center (CSC)
11.6 CSC 2.0 Scheme
11.7 Financial Inclusion through Common Services Centers (CSC) Scheme
11.8 Tele Centers
11.9 Summary
11.10 Key Words
11.11 Self-Assessment Questions
11.12 Suggested Readings

11.1. INTRODUCTION

In the last couple of years, India has witnessed important developments that have significantly impacted the delivery of financial inclusion (FI) services right up to the grassroots. The term "financial inclusion" has gained momentum in past few years, as a result of findings about 'financial exclusion and its direct correlation to poverty'. With that, achieving FI became a common objective for many central banks and Governments among the developing nations. In India, the big push came on April 26, 2010, when Reserve Bank of India (RBI), as a part of its FI mandate issued guidelines to Banks for delivery of financial services through the Common Services Centers (CSCs). The RBI in its Annual Policy Statement for the year 2010-11, allowed banks to engage companies (excluding Non Banking Financial Companies (NBFCs) registered under the Indian Companies Act, 1956, as Business Correspondents (BCs) in addition to individuals/entities permitted earlier. Further, the RBI allowed banks to engage the Common Service Centres' Operators / Village Level Entrepreneurs as BCs.

Further, February 15, 2011 was another landmark day, as Swabhiman Scheme was formally launched. The objective of the Scheme being "Make banking facility available to all citizens". Besides this Government of India, Department of financial services issued instruction to Banks to appoint CSC as the business correspondent. Specifically, these initiatives and some other related developments set in motion the financial inclusion agenda in the country. In order to provide the much needed thrust a flagship programme in mission mode called the Pradhan Mantri Jan- Dhan Yojna (PMJDY) was launched by Hon'ble Prime Minister on 28th August 2014. With this launch, The Bank Mitr / Banking Correspondent Agent (BCAs) at the Grass Root level has now become the extended arm of the Banks, these BCAs have a vital role in successful implementation of Financial Inclusion and PMJDY.

Common Services Centres are the access points for delivery of Government-to-Citizen (G2C) e-Services within the reach of the citizen, by creating the physical service delivery ICT infrastructure. It helps in making a transparent service delivery mechanism and reducing citizens' effort in visiting government offices. Common Services Centre (CSC) programme is an initiative of the Ministry of Electronics & IT (MeitY), Government of India. CSCs are the access points for delivery of various electronic services to villages in India, thereby contributing to a digitally and financially inclusive society. Common Services Centre are the access points for delivery of Government to Citizen (G2C) e-services within the reach of the citizen, by creating the physical service delivery ICT infrastructure. It helps in making a transparent service delivery mechanism and reducing citizen’s effort in visiting government offices. CSCs are more than service delivery points in rural India. They are positioned as change agents, promoting rural entrepreneurship and building rural capacities and livelihoods. They are enablers of community participation and collective action for engendering social change through a bottom-up approach with key focus on the rural citizen.

11.2. OBJECTIVES OF CSC

CSCs are more than service delivery points in rural India. They are positioned as change agents, promoting rural entrepreneurship and building rural capacities and livelihoods. They are enablers of community participation and collective action for engendering social change through a bottom-up approach with key focus on the rural citizen.CSC 2.0 is a service delivery oriented entrepreneurship model with a large bouquet of services made available for the citizens through optimum utilization of infrastructure already created in the form of SWAN, SSDG, e-District, SDC, and NOFN/BharatNet.

- Non-discriminatory access to e-Services for rural citizens by making CSCs complete service delivery centres, utilizing the infrastructure already created in terms of other Mission Mode Projects.
- Expansion of self-sustaining CSC network till the Gram Panchayat level – 2.5 lakh CSCs, i.e. at least one CSC per Gram Panchayat, more than one preferred.
- Empowering District e-Governance Society (DeGS) under the district administration for implementation.

- Creating and strengthening the institutional framework for rollout and project management, thereby, supporting the State and District administrative machinery and handholding of VLEs through local language Help Desk support.
- Enablement and consolidation of online services under single technology platform, thereby making the service delivery at CSCs accountable, transparent, efficient and traceable, with a technology-driven relationship between all stakeholders.
- Providing Centralized Technological Platform for delivery of various services in a transparent manner to the citizens.
- Increasing sustainability of VLEs by sharing maximum commission earned through delivery of e-services and encouraging women to join as VLEs.

11. 3. SERVICES PROVIDED BY COMMON SERVICE CENTERS (CSCs)

Various services are being provided to the people by Common Services Centers (CSCs) in India. The CSC are now available in various places in a District around the country. The services i.e. G2C (Government to Consumer), B2C (Business to Consumer) and B2B (Business to Business) are successfully provided by Common Service Centers in India.

1. Government to Consumer (G2C)

Various Government Services like Birth/ Death Certificate, Forms Download and Submission, Property Tax and Registration, Bus Pass, Railway Ticket, Passport , Licenses, Permit , Subsidies etc. are provided by CSC centers at one place for convenience of citizens. Detail of services provided by centers is as-

- Insurance Services
- Passport
- Premium Collection Services of LIC, SBI, ICICI Prudential, AVIVA DHFL and Other Insurance Companies
- E-Nagrik& E- District Services {Birth/ Death Certificate etc.}
- Pension Services
- NIOS Registration
- Apollo Telemedicine
- NIELIT Services
- Aadhar Printing and Enrollment
- PAN Card
- Electoral Services
- E-Courts and Results Services
- State Electricity and Water Bill Collection Services
- IHHL Project of MoUD (Swachh Bharat)
- Digitize India
- CyberGram
- Services of Department of Post

2. Business to Consumer (B2C)

List of Services provided by CSC from Business to Citizens is as-

- Online Cricket Course
- IRCTC, Air and Bus Ticket Services

- Mobile and DTH Recharge
- English Speaking Course
- E- Commerce Sales (Book, Electronics, Households Items etc.)
- Agriculture Services
- CSC Bazaar
- E Learning

3. Business to Business(B2B)

Services like Market Research, Rural BPO (Data Collection, Digitalization of Data) comes under B2B.

4. Educational Services

Various types of Educational Services are also provided by CSC-

Adult Literacy- Adult Literacy is ability to use a language fro reading, writing, speaking, Listening. This service is offered through TARA Akshar+

IGNOU Services- Examination Form, Results declaration, Students Admission or Offering courses from IGNOU etc. services being provided by CSC.

Digital Literacy- It includes Computer Courses, provide It skills to ASHA and Anganwadi Workers and authorised Ration Card Holder, Investor Awareness Programmes, NABARD Financial Literacy Programme etc.

MKCL Services- The Maharashtra Knowledge Corporation Limited (MKCL) has been offering various vocational and technical courses through online mode.

NIELIT Services- Online Registration/ Fee Collection, Online Examination Form submission and printing of examination.

NIOS Services- CSC act as NIOS Facilitation Centers for promotion of Open Schooling in Rural Areas, Registration of Students, Payment of Examination Fees, Declaration of Results.

5. Financial Inclusion

Financial Services like Banking, Insurance and Pension are provided to Citizens in Rural and Remote Areas, particular Women and marginalised Communities, to secure their livelihood.

Banking- Variety of Banking services like Deposit, Withdrawal, Balance Enquiry, Statement of Accounts, Recurring Deposit Accounts, Overdraft, Retail Loan, General Purpose Credit Card, Kisan Credit Card, Credit Facilities to Borrower etc. can be availed through CSC. It has partnered with 42 public and private sector and regional rural banks.

Insurance- CSC is providing Insurance products and services through Authorised Village Level Enterpreneur (VLE). In addition services for LIfe Insurance, Health Insurance, Crop Insurance, Personal Accident, Motor Insurance etc. is provided.

Pension- CSCs promote the National Pention System in Rural and Semi- Urban Areas through Opening Tier 1 and Tier 2 Accounts, Deposit Contribution etc.

6. Other Services

Agriculture- To avail the agriculture services, Farmer registration is done. It helps the farmers to receive advisories related to it from experts. In addition, many other services like Weather Information, Soil Information is also provided to the citizens.

Recruitment- Notification for Recruitment in Indian Navy, Indian Army, Indian Air Force is provided.

Income Tax Filling- Income Tax Returns can also be filed through CSC. Manual is available in English and Hindi for VLE

11.4 REQUIREMENTS FOR REGISTERING CSC

If you want to Start a CSC (Common Service Center) in your area, you must have Eligibility to Participate in CSC Scheme. If you are eligible, you need to have the required infrastructure also. Details like Eligibility, Educational Qualification, Age Limit and Required Infrastructure is available on this page.
Criteria for participation in Common Service Services is as below-
Desirous person should be a local person.
Age-Applicant must have attained the age of 18 years.
Qualification-Person should preferably have passed the Matriculation Level Examination or equivalent from recognized board.
Other Requirements-

- Applicant should have fluency in reading and writing the local language.
- Should have the basic knowledge of English Language and Computer Skills.

Infrastructure Required for Starting a CSC Center

If you want to Start a CSC (Common Service Center) in your area, you must have Eligibility to Participate in CSC Scheme. If you are eligible, you need to have the required infrastructure given here.
Common Service Center Scheme has been formulated by the Government to provide E-Services to citizens by establishing a common center under the Digital India Programme. Government envisage on establishing the 1,00,000 (One Lac) CSCs across the India. Eligible person can start CSC by approaching the Service Center Agency (SCA) of that respective area. Prerequisite to start a CSC is as-

Required CSC Infrastructure shall be as-

1. Room/Building having place of 100-150 Sq. Ft.
2. Two PC's with UPS with 5 hours battery back-up or portable generator set. PC with licensed Operating System of Windows XP-SP2 or above.
3. Two Printers. (Inkjet+ Dot Matrix)
4. RAM having the minimum storage capacity of 512 MB
5. Hard Disc Drive of at least 120 GB
6. Digital Camera/ Web Cam

7. Wired/ Wireless/V-SAT Connectivity
8. Biometric/IRIS Authentication Scanner fro Banking Services.
9. CD/DVD Drive

Total Estimated Cost per CSC will be 1.25 to 1.50 Lacs (Except Land & Building)

11.5 HOW TO START A COMMON SERVICE CENTER (CSC)

Process to Register for A Common Service Center (CSC) and Starting a New CSC in Your Area and Check Status Online- Any person who wants to open the Common Service Center and fulfills the eligibility can apply online. Application Procedure for setting up of CSC is as-

1. Open the CSC Portal i.e. *www.csc.gov.in*
2. Click on “Interested to become a CSC” on the left side of the page.
3. Click on Link given ” For CSC Registration, Click Here”
4. Enter the Aadhar Number in required box.
5. After that choose the authentication Option from IRIS/ Finger Print/ One Time Password. Click on “Proceed”. Applicant have to pass through OTP Process.
6. Click on Generate OTP. (Personal details of the applicant will automatically get filled from Aadhar data base. Applicant need to fill other details. Mobile Data and Email Id will be taken from Aadhar Card, same can’t be modified until change is not made in Aadhar.)
7. Upload the Geo-tagged Image of Centers.
8. Click on SUBMIT Option.

On submission of Application, acknowledgement number will be sent to applicant.

11.6 CSC 2.0 SCHEME

Under the Digital India programme, at least one CSC (preferably more than one) is envisaged in 2.5 lakh Gram Panchayats for delivery of various electronic services to citizens across rural India. This would include strengthening and integrating the existing 100,000 CSCs under the CSC scheme and making operational an additional 1.5 lakh CSCs in Gram Panchayats.

CSC 2.0 is a service delivery-oriented entrepreneurship model with a large bouquet of services made available for the citizens through optimum utilization of infrastructure already created in the form of SWAN, SSDG, e-District, SDC, and NOFN/BharatNet.

Objectives of CSC 2.0

- Non-discriminatory access to e-Services for rural citizens by making CSCs complete service delivery centres, utilizing the infrastructure already created in terms of other Mission Mode Projects.
- Expansion of self-sustaining CSC network till the Gram Panchayat level – 2.5 lakh CSCs, i.e. at least one CSC per Gram Panchayat, more than one preferred.
- Empowering District e-Governance Society (DeGS) under the district administration for implementation.

- Creating and strengthening the institutional framework for rollout and project management, thereby, supporting the State and District administrative machinery and handholding of VLEs through local language Help Desk support.
- Enablement and consolidation of online services under single technology platform, thereby making the service delivery at CSCs accountable, transparent, efficient and traceable, with a technology-driven relationship between all stakeholders.
- Providing Centralized Technological Platform for delivery of various services in a transparent manner to the citizens.
- Increasing sustainability of VLEs by sharing maximum commission earned through delivery of e-services and encouraging women to join as VLEs.

11.7 FINANCIAL INCLUSION THROUGH COMMON SERVICES CENTERS (CSC) SCHEME

Financial Inclusion is an Integral Part of the CSC ecosystem with a clear focus on Banking for the unbanked. The Common Services Centers (CSC) Scheme is being implemented across the country under the Digital India initiative by Department of Electronics and Information Technology (DEITY), Ministry of Communications & Information Technology, Government of India. The aim of the Scheme is to provide sustainable digital access to make e-governance services for upliftment of rural community. The CSC Scheme is a strategic cornerstone of the Digital India initiative of Government of India.

As on Mar 2015 over 1.44 lacs CSCs have been set up across the country, covering 35 States/ UTs. One CSC caters over five to six villages. The CSCs are being set up in the Public Private Partnership (PPP) mode. The CSCs are delivering various services which include Birth, Death, Caste, Income, Domicile Certificates, NREGA services, Health services, Banking & insurance services, e-learning/digital literacy and Telemedicine. The Scheme is being implemented through a Public Private Partnership (PPP) model. Some of the key stakeholders in the project include the Central Government, State Designated Agency (SDA), Service Centre Agency (SCA), Service Providers (SP), Banks, and the Village level Entrepreneur (VLE)

a. The Facilitator: Role of CSC SPV

As envisaged under the Scheme, a National level Special Purpose Vehicle (SPV) has been formed as a permanent entity to provide ongoing support to the CSCs and to catalyze services to be channelized through the network. CSC SPV is called CSC (e-GOVERNANCE SERVICES INDIA LTD). The CSC SPV is playing a proactive role in ensuring that the national network of CSCs is leveraged to meet India's financial inclusion mandate for rural areas by enabling the issuance of standardized guidelines for Government Scheme linkages, enabling processes for State Designated Agencies (SDAs) to take action and intervening in regions where SCAs are unwilling to enable financial inclusion.

b. Leveraging CSCs for Delivering Financial Services

As per the RBI guidelines, FI has become a mandate for all banks. Clear targets have been assigned as part of their Financial Inclusion Plan as also approved by the RBI. Consequently, the Banks have signed BC agreements with various service providers to deliver financial services. Further, CSC SPV as a corporate Banking Correspondent has signed agreement with 42 Banks

(Public Sector Banks, Regional Rural Bank and Private Sector Banks) to enabling CSCs to become Banking Correspondent Agents / Customer service points that deliver various banking and financial services in a number of States across the country. CSC SPV is also supporting the State Designated Agencies in States in proactively supporting these initiatives, thereby increasing the sustainability of these initiatives.

Also as per a letter issued by Department of Financial Services (DFS) to Banks regarding Financial Inclusion Strategy and Guidelines, it was clearly stated that "In order to ensure convergence and to assist viability of BC, it would be necessary that in the villages to be covered, wherever a CSC exists, the CSC is made a BC." Thus in view of the advantage that the CSCs enjoy due to their location, accessibility and availability of ICT infrastructure it is best poised to deliver financial services in rural India. Role of the State Government in promoting financial inclusion through CSC many states have decided in the State level Bankers committee meeting to monitor the financial inclusion targets assigned to banks and also that all the EBT in the state shall be disbursed through the CSC.

c. Financial Literacy by CSC:

In light of the importance of the financial inclusion agenda for the country, and to highlight the role CSC network needs to play, various banks organized workshops at state and district level to accelerate delivery of financial services through the CSCs. The idea behind organizing the workshop is to get together all stakeholders on one platform in order to highlight the status, success stories (of people from the ground the VLEs and SCAs), gaps in delivering financial services, and defining the road ahead and deliverables.

d. VLE Case Studies:

Initial implementations indicated that when banking is linked with disbursement of rural Government scheme benefits and wages, a BC can earn a minimum of Rs. 3000 per month, per CSP. Currently many VLEs are earning more than Rs.20, 000/- per month.

e. Defining Success Parameters:

The success of financial inclusion depends on the availability of internet connectivity, VLE training and motivation, linkages with Government schemes disbursement, community awareness and sensitization and VLE selection.

11.8 TELE CENTERS

A telecentre is a public place where people can access computers, the Internet, and other digital technologies that enable them to gather information, create, learn, and communicate with others while they develop essential digital skills. Telecentres exist in almost every country, although they sometimes go by a different names including public internet access center (PIAP), village knowledge center, info-center, Tele-cottage, Electronic Village Hall, community technology center (CTC), community multimedia center (CMC), multipurpose community telecentre (MCT), Common/Citizen Service Centre (CSC) and school-based tele centre. While each tele-centre is different, their common focus is on the use of digital technologies to support community, economic, educational, and social development—reducing isolation, bridging the

digital divide, promoting health issues, creating economic opportunities, leveraging information communications technology for development (ICT4D), and empowering youth.

Purpose

The purposes of establishing telecentre are:

- To transform the digital divide into digital opportunity in rural and remote areas of developing country;
- To provide the most effective solution in rural area for sharing the use of internet or ICT facilities among the communities;
- To create a knowledge centre in rural community;
- to educate people and to enrich living standard by having access to global information through the internet technology;
- To promote the sale of local product through the internet or electronic commerce applications;
- To provide government information such as natural disaster warning, announcement, e-government services and other e-services to the local communities.

Advantages

With capable call center financial services at your disposal, you'll do much more than satisfy customer communication protocols. Your company will also enjoy:

- **Brand-boosting marketing.** With our built-in marketing tools—including lead response management resources—your financial call center will play a part in developing a marketing strategy that works.
- **Proven scripts, automated technology & more**. At TeleDirect, we provide a fantastic inbound and outbound call center for financial services. Our expert live agents and automated infrastructure both keep your customer communications at the forefront of everything you do.
- **Live agent support**. If required, Tele Direct's top-trained agents can help with your most pressing financial call center needs—we're connected 24/7.

11.9 SUMMARY

To change the community and to make them more informed a Village Level Entrepreneur (VLE) can play a constructive role, for this it is important for a VLE to understand what telecentre as a technology can do. Once he/she experiences that the technologies can make the life of the community better, he/she can connect them with new information and make the life of citizens better. The telecentre movement is one of the powerful initiative of bringing together technology (i.e. both computers and Internet) for community development. In this Unit the VLE is introduced to details related to the telecentre movement, in India and Globally. It also covers details about different kinds of telecentres and their functions. At the end of the module it explains the linkage between Governance, E-Governance and telecentres.

11.10 KEY WORDS

1. Pradhan Mantri Jan-Dhan Yojana (PMJDY) is National Mission for Financial Inclusion to ensure access to financial services, namely, a basic savings & deposit accounts, remittance,

credit, insurance, pension in an affordable manner. Under the scheme, a basic savings bank deposit (BSBD) account can be opened in any bank branch or Business Correspondent (Bank Mitra) outlet, by persons not having any other account.

2. Business-to-employee (B2E) electronic commerce uses an intra-business network which allows companies to provide products and/or services to their employees.

3. **E-GOVERNANCE:** E-governance, meaning 'electronic governance' is using information and communication technologies (ICTs) (such as Wide Area Networks, the Internet, and mobile computing) at various levels of the government and the public sector and beyond, for the purpose of enhancing governance.

4. Financial inclusion: It refers to efforts to make financial products and services accessible and affordable to all individuals and businesses, regardless of their personal net worth or company size.

5. VLE and CSC : VLE is Village Level Entrepreneur who delivers various government and non-government services to the end consumers from the Common Service Centres outlet.

11.11 SELF ASSESSMENT QUESTIONS:

Essay type questions:

1. What are the major services offered by CSCs
2. Examine the requirements for registering CSCs
3. Write a note on Inclusion through CSCs

Short Answer questions:

1. What do you mean by Common Service Centres
2. What are the objectives of CSCs
3. CSC 2.0 Scheme
4. The concept of Tele Centre

11.12 SUGGESTED READINGS

1. Agarwal, O.P “Modern banking of India”, Himalaya Publishing house, New Delhi, 2015
2. Rahul Bajoria, “The story of Reserve Bank of India”, Edward & Eagar Publications (2018)
3. . https://services.global.ntt/en-US/about-us/case-studies/tele-centre-services
4. Mithani, D.M., “Money, Banking and International Trade”, Himalaya Publishing House, New Delhi, 2009
5. Parameswaran., R, “Indian Banking”, S. Chand Publications, New Delhi, 2009
6. RBI Functions and working, RBI Publications, 2020
   7.https://gramawardsachivalayam.ap.gov.in/gsws/downloads/CSC/Trainings/CSC%20TEC%20Learning%20Material-compressed.pdf
7. https://en.wikipedia.org/wiki/Telecentre

Dr. P. Venu Gopal

LESSON – 12
ROLE OF MICRO FINANCE AND CHIT FUNDS IN INDIA

Aims and Objectives:

After reading this lesson the student would know the following aims and objectives of:

- To understand the objectives of micro finance
- To know the role and importance of micro finance in India
- To understand the challenges of micro finance institutions in India
- To know the chit fund schemes in India

Structure

12.1 Introduction
12.2 Objectives of micro finance
12.3 Importance of micro finance
12.4 Channels of micro finance
12.5 MUDRA
12.6 Benefits of micro finance
12.7 History and evolution of micro finance in India
12.8 Role of micro finance
12.9 Current status of micro finance in India
12.10 Micro finance institutions in India
12.11 Challenges faced by micro finance institutions in India
12.12 Criticism of micro finance
12.13 Chit funds
12.14 How to invest in the chit fund schemes
12.15 Benefits of chit funds
12.16 Types of chit funds
12.17 Advantages of investing in chit funds
12.18 Risks involved investing in chit funds
12.19 Summary
12.20 Key words
12.21 Self-assessment questions
12.22 Suggested readings

12.1 INTRODUCTION

Micro Finance is a non-profit organization that provides financial assistance to low-income people. Microloans, micro-savings, and micro insurance are examples of these services. Micro Finance in India is financial institutions that make small loans to persons who do not have access to traditional banking services. The term “small loans” is defined differently in different nations. In India, it is defined as loans of less than one lakh rupees. Micro finance institutions in India has risen significantly in India over the last two decades, and it now serves roughly 102 million impoverished people’s accounts (including banks and small financing banks). Microfinance, also called micro credit, is a type of banking service provided to low-income individuals or groups who otherwise wouldn't have access to financial services. While institutions participating in microfinance most often provide lending—microloans can range from as small as $50 to under $50,000. But many banks

offer additional services such as checking and savings accounts as well as micro-insurance products, and some even offer financial and business education. The goal of microfinance is to ultimately give impoverished people an opportunity to become self-sufficient.

Microfinance services are provided to unemployed or low-income individuals because most people trapped in poverty, or who have limited financial resources, don't have enough income to do business with traditional financial institutions. Despite being excluded from banking services, however, people who live on as little as $2 a day *do* attempt to save, borrow, or acquire credit or insurance, and they do make payments on their debt. Thus, many poor people typically look to family, friends, and even loan sharks (who often charge exorbitant interest rates) for help. Microfinance allows people to take on reasonable small business loans safely, and in a manner that is consistent with ethical lending practices. Although they exist all around the world, the majority of micro financing operations occur in developing nations, such as Bangladesh, Cambodia, India, Afghanistan, Democratic Republic of Congo, Indonesia, and Ecuador. Many microfinance institutions, sometimes referred to as MFIs, focus on helping women in particular.

12.2. OBJECTIVES OF MICRO FINANCE

- Transform into a financial institution that supports the development of sustainable communities.
- Assist in the supply of resources that benefit the poorest members of society. In this aspect, women are given special attention because they have successfully established income-generating businesses.
- Examine the choices available to aid in the faster eradication of poverty.
- Encourage poor people to start their businesses.
- Empowering rural people by teaching them basic skills so that they can start their enterprises and earn money.

12.3. IMPORTANCE OF MICRO FINANCE

Almost half of the population of our country does not have a basic savings account. However, this segment requires financial services so that their aspirations such as building of assets and protection against risk can be fulfilled.

Microfinance provides access to capital for individuals who are financially underserved. If microfinance institutions were not offering loans to this segment of the society, these groups would have resorted to borrowing money from friends or family members. The probabilities of them opting for fast cash loans or pay day advances (that bear huge interest rates) are also high. Micro finance helps these groups invest wisely in their businesses, and hence, is in alignment with the government's vision of financial inclusion in the country.

12.4. CHANNELS OF MICRO FINANCE

Microfinance channels are the various mechanisms and institutions through which microfinance services are delivered to underserved populations. These channels ensure that financial services such as credit, savings, insurance, and remittances reach those who lack

access to traditional banking systems. Here's an overview of the key channels of microfinance:

1. Microfinance Institutions (MFIs)
Overview: MFIs are specialized financial institutions that provide microloans and other financial services to low-income clients.
Types:
Non-Governmental Organizations (NGO-MFIs): NGOs that have microfinance as part of their broader development activities.
Non-Banking Financial Companies (NBFC-MFIs): Regulated by the Reserve Bank of India (RBI), these are for-profit entities specializing in microfinance.
Cooperative Societies: Member-owned organizations that provide financial services to their members.
Services: Loans, savings, insurance, and financial literacy programs.
Advantages: Expertise in microfinance, deep community reach, and tailored financial products.

2. Self-Help Groups (SHGs)
Overview: SHGs are small, informal groups of people who come together to save money and access credit.
Structure: Typically consists of 10-20 members who pool their savings and lend to each other.
Support: Often supported by NGOs, government programs, and banks.
Advantages: Promotes savings, mutual support, and empowerment, especially among women.

3. Banks
Overview: Traditional banks have increasingly become involved in microfinance, either directly or through partnerships.
Initiatives:
Priority Sector Lending: Indian banks are mandated to lend a certain percentage of their total loans to the priority sector, which includes agriculture, small enterprises, and low-income individuals.
Business Correspondents (BCs): Banks appoint BCs to extend their reach into rural areas. BCs act as intermediaries, facilitating banking services.
Advantages: Access to a wide range of financial products, regulatory oversight, and financial stability.

4. Microfinance Banks
Overview: Specialized banks that focus on providing microfinance services.
Examples: Small Finance Banks (SFBs) in India, which serve underserved segments with a focus on financial inclusion.
Advantages: Comprehensive financial services tailored to the needs of microfinance clients, regulated environment.

5. Credit Unions and Cooperatives
Overview: Member-owned financial cooperatives that provide credit and other financial services to their members.
Structure: Operate on a democratic basis, with members having a say in decision-making.
Advantages: Community focus, member-driven policies, and lower interest rates.

6. Digital Financial Services and Fintech

Overview: The rise of technology has led to new channels for delivering microfinance through digital platforms.

Services: Mobile banking, digital wallets, peer-to-peer lending platforms, and app-based microloans.

Advantages: Increased accessibility, reduced transaction costs, convenience, and broader reach.

7. Government Programs and Schemes

Overview: Governments often launch specific programs aimed at financial inclusion.

Examples:

Pradhan Mantri Jan Dhan Yojana (PMJDY): A national mission for financial inclusion in India.

Pradhan Mantri MUDRA Yojana (PMMY): Provides microloans to non-corporate, non-farm small/micro enterprises.

Advantages: Large-scale reach, integrated support services, and focus on socio-economic development.

8. Non-Governmental Organizations (NGOs)

Overview: NGOs play a crucial role in promoting microfinance by forming and nurturing SHGs, providing capacity-building, and linking groups to banks and MFIs.

Services: Financial literacy, business development services, and advocacy.

Advantages: Strong community ties, focus on empowerment, and capacity-building.

The diverse channels of microfinance collectively work towards bridging the financial inclusion gap by providing tailored financial services to underserved populations. Each channel has its unique strengths and plays a complementary role in the broader microfinance ecosystem. Effective collaboration among these channels can enhance the reach and impact of microfinance, contributing to the socio-economic development of marginalized communities.

12.5.MUDRA

The Pradhan Mantri MUDRA Yojana (PMMY) is a program introduced by the Honorable Prime Minister on April 8, 2015, with the aim of offering loans of up to 10 lakh to small and micro enterprises that are not part of the corporate or agricultural sectors. These loans fall under the category of MUDRA loans within the framework of PMMY. These financial facilities are extended by various institutions such as Commercial Banks, Regional Rural Banks (RRBs), Small Finance Banks, Micro Finance Institutions (MFIs), and Non-Banking Financial Companies (NBFCs). Borrowers can approach any of the above lending institutions or submit their applications online through Uday Mitra.

OBJECTIVES OF MUDRA

- **Financial Inclusion:** MUDRA aims to extend affordable credit to micro and small enterprises (MSEs) which are often excluded from the formal banking system. This initiative seeks to integrate these enterprises into the financial mainstream.
- **Employment Generation:** By providing financial assistance to small businesses, MUDRA promotes entrepreneurship and helps create employment opportunities across various sectors.

- **Economic Development:** The scheme focuses on improving the socio-economic conditions of small entrepreneurs, thereby contributing to overall economic growth.

KEY FEATURES OF MUDRA

Types of Loans:

- **Shishu:** Loans up to ₹50,000, aimed at startups and early-stage businesses.
- **Kishore:** Loans ranging from ₹50,001 to ₹5,00,000, for businesses looking to expand or improve their operations.
- **Tarun:** Loans from ₹5,00,001 to ₹10,00,000, for established enterprises seeking further growth.
- **Collateral-Free Loans:** One of the most significant features of MUDRA loans is that they are collateral-free, reducing the risk for small entrepreneurs and encouraging more individuals to avail of these financial services.
- **Interest Rates and Repayment:** The interest rates under the MUDRA scheme are competitive and vary according to the lending institution and the borrower's profile. The repayment period is flexible, making it easier for businesses to manage their finances.
- **MUDRA Card:** A unique feature of the scheme is the MUDRA Card, which functions like a credit card and can be used for working capital requirements. This card allows borrowers to withdraw funds as needed, providing flexibility in managing day-to-day operations.

BENEFITS OF MUDRA

1. **Accessibility:** The scheme is designed to be accessible to a wide range of micro and small enterprises, including non-corporate small business segments such as proprietorships, partnership firms, and other small entities engaged in manufacturing, trading, and service activities.
2. **Boost to Micro-Entrepreneurs:** By providing much-needed financial support, MUDRA empowers micro-entrepreneurs to start new ventures or expand existing ones, contributing to local economic development and job creation.
3. **Women Empowerment:** A significant number of MUDRA loans have been disbursed to women entrepreneurs, promoting gender equality and economic empowerment of women.
4. **Support to Various Sectors:** MUDRA loans support a wide array of sectors, including agriculture, retail trade, services, and manufacturing. This diversified support helps in balanced regional development.
5. **Formalization of Informal Sector:** By extending credit to small businesses in the informal sector, MUDRA helps in the formalization of these businesses, enabling them to avail of other government benefits and services.

12.6. BENEFITS OF MICRO FINANCE

Microfinance has emerged as a powerful tool for poverty alleviation and socio-economic development in India. Here are the key benefits of microfinance in the Indian context:

1. Financial Inclusion - Microfinance extends financial services to the underserved and unbanked sections of society, particularly in rural and semi-urban areas. By providing access

to savings accounts, loans, and insurance products, microfinance institutions (MFIs) play a crucial role in integrating marginalized communities into the formal financial system.

2. Economic Empowerment -Microfinance empowers individuals, especially women, by providing them with the necessary capital to start or expand small businesses. This not only enhances their economic independence but also contributes to household income, thereby improving the overall standard of living.

3. Entrepreneurship Development - Access to microfinance encourages entrepreneurship among the poor. Small loans help budding entrepreneurs to invest in their businesses, purchase inventory, and improve their operations. This entrepreneurial boost leads to job creation and stimulates local economies.

4. Reduction in Poverty - By facilitating income-generating activities, microfinance directly contributes to poverty reduction. The additional income from these activities helps families meet their basic needs, such as food, education, and healthcare, leading to a better quality of life.

5. Social Empowerment - Microfinance often involves forming self-help groups (SHGs) that foster a sense of community and solidarity. These groups provide a platform for members to share experiences, support each other, and collectively negotiate better terms with MFIs. This collective empowerment strengthens social networks and enhances community cohesion.

6. Improved Access to Education and Healthcare - The additional income generated through microfinance enables families to invest in their children's education and access better healthcare services. This long-term investment in human capital has a profound impact on the socio-economic development of communities.

7. Reduction in Exploitation by Moneylenders - Microfinance provides a viable alternative to traditional moneylenders who often charge exorbitant interest rates. By offering lower and more manageable interest rates, MFIs help reduce the financial burden on borrowers and protect them from falling into debt traps.

8. Women Empowerment - A significant proportion of microfinance clients are women. Access to financial resources empowers women to take on entrepreneurial ventures, gain financial independence, and have a greater say in household decisions. This shift not only benefits individual women but also promotes gender equality within communities.

9. Resilience Building - Microfinance helps build financial resilience among low-income households. Savings products and micro-insurance schemes enable families to better manage risks and uncertainties, such as health emergencies or natural disasters.

10. Technological Integration - Many MFIs are leveraging technology to improve service delivery. Mobile banking, digital payments, and other fintech innovations enhance the accessibility, efficiency, and transparency of microfinance services, making it easier for clients to manage their finances.

12.7. HISTORY AND EVOLUTION OF MICRO FINANCE IN INDIA

The history of microfinance in India is a rich and evolving narrative that spans several decades, characterized by various phases and significant milestones. Here is an overview of the key developments:

EARLY BEGINNINGS

Pre-independence era

Traditional Savings Groups: Informal savings and credit groups have existed in India for centuries, such as Rotating Savings and Credit Associations (ROSCAs), known locally as chit funds or nidhis. These were community-based initiatives for mutual financial assistance.

Post-Independence Developments

1950s-1970s

Cooperative Movement: Post-independence, the Indian government promoted cooperative societies to facilitate rural credit. The focus was on agricultural credit and the establishment of cooperative banks.

1980s

Self-Help Groups (SHGs): The concept of SHGs started gaining momentum in the 1980s, aimed at empowering women and promoting small savings among rural communities. These groups, usually consisting of 10-20 members, pooled their savings to provide loans to each other at low interest rates.

NABARD's Role: The National Bank for Agriculture and Rural Development (NABARD) was established in 1982 and played a crucial role in promoting SHGs and linking them with formal banking institutions.

MODERN MICROFINANCE MOVEMENT

1990s

SHG-Bank Linkage Program (SBLP): Initiated by NABARD in 1992, this program aimed to integrate SHGs with the formal banking sector. The SBLP became a cornerstone of microfinance in India, significantly expanding the reach of microcredit to rural areas.

Entry of NGOs and MFIs: Non-Governmental Organizations (NGOs) and Microfinance Institutions (MFIs) started to emerge, providing microcredit to the underserved population. Organizations like SEWA (Self-Employed Women's Association) and MYRADA (Mysore Resettlement and Development Agency) were pioneers in this space.

2000s

Rapid Growth: The early 2000s saw rapid growth in the microfinance sector with an increasing number of MFIs operating across the country. Commercialization and the entry of private players marked this period.

Microfinance Bill: The Microfinance Institutions (Development and Regulation) Bill, 2007, was proposed to regulate the sector, though it faced several challenges and delays.

2010s

Andhra Pradesh Crisis (2010): A major crisis erupted in Andhra Pradesh due to allegations of coercive recovery practices by MFIs, leading to a crackdown on the sector and the imposition of strict regulations.

RBI Regulation: Post-crisis, the Reserve Bank of India (RBI) stepped in to regulate MFIs more rigorously, categorizing larger MFIs as Non-Banking Financial Company-Microfinance Institutions (NBFC-MFIs) and setting guidelines for their operation.

Micro Units Development and Refinance Agency (MUDRA): Launched in 2015, MUDRA aims to provide loans to small and micro enterprises, further expanding the reach of microfinance.

2020s

Digital Transformation: The recent years have seen a shift towards digital microfinance, leveraging technology to enhance financial inclusion. Fintech companies are increasingly partnering with traditional MFIs to offer innovative financial products and services.

12.8.

12.9. ROLE OF MICRO FINANCE

Micro finance institutions have a specific focus: they aim to offer banking services to low-income individuals and groups, and they receive funding from established financial institutions to support the under privileged. Consequently, these institutions have become powerful tools in the fight against poverty in India.

Micro finance services are provided through various sources, including:

- Formal institutions like rural banks and cooperatives.
- Semiformal organizations, often non-governmental entities.
- Informal sources, including small-scale lenders and shop owners.
- Institutional micro finance encompasses offerings from both formal and semiformal institutions, with some MFIs being well-managed and self-sufficient in their operations.

Different categories of institutions are involved in providing micro finance in India, such as:

- Commercial banks.
- Credit unions.
- NGOs (Non-Governmental Organizations)
- Sectors within government banks.
- Cooperatives.

These institutions not only offer micro credit but also supplementary financial services like insurance, savings, and remittances. Moreover, they provide non-financial services such as training, counseling, and support for borrowers in the most convenient manner possible. Borrowers have the flexibility to determine interest rates based on loan purpose and their own financial history, as well as their repayment schedules.

12.10. CURRENT STATUS OF MICRO FINANCE IN INDIA

- As of March 31, 2022, the program covers 140 million families and 11.9 million SHG groups with cumulative savings of $472.4 billion.
- During FY 2021-22, 3.4 million SHGs were credit linked, and loans worth $997.2 billion were disbursed, with a credit outstanding of $1,510.5 billion for 6.74 million SHGs (an average of $0.24 million per SHG).
- The E-Shakti program digitized data of over 1.2 million SHGs to facilitate credit linkage with banks, aiming to improve the process.
- The figure below displays the state-wise credit linkage status of SHGs as of December 31, 2022, where 57% of SHGs with savings have loans outstanding with banks.
- Nine states have a credit linkage percentage higher than the all-India average, with Andhra Pradesh leading at 90% of its SHGs having outstanding loans, followed by Bihar (89%) and Karnataka (87%). Southern and Eastern states, along with Tripura, dominate the list.

12.11. MICRO FINANCE INSTITUTIONS IN INDIA

Micro finance institutions in India organize a variety of groups to provide credit, insurance, and financial instruction to the rural population

Micro finance Group	**Description**
Self Help Group (SHG)	• A Self-Help Group is a collection of people who share similar socio economic backgrounds. • These small business owners band together for a limited time to form a shared fund for their mutual business needs. These organizations are classified as non-profits. The debt collection is handled by the group. • This type of group lending does not require any kind of collateral. In addition, interest rates are often cheap. • Several banks have formed partnerships with SHGs in order to increase financial inclusion in the country's rural areas.
Joint Liability Group (JLG)	• This is usually an informal group of 4-10 people who seek loans on the basis of a mutual guarantee. • The loans are typically used for agriculture or related operations. • This group of borrowers includes farmers, rural workers, and tenants. • Each member of a JLG is equally liable for the timely repayment of the loan. • This institution does not require any financial administration.
Grameen Model Bank	• Nobel Laureate Prof. Muhammad Yunus developed the Grameen Model in Bangladesh in the 1970s. • It prompted India to establish Regional Rural Banks (RRBs). • The major goal of this approach is to grow the rural economy from beginning to end.
Rural Cooperatives	• At the time of India's independence, rural cooperatives were formed. • Through this fund, Poor people's resources were pooled, and financial services were offered.

12.12. CHALLENGES FACED BY MICRO FINANCE INSTITUTIONS IN INDIA

- Impact of COVID-19: It has impacted the MFI industry, with collections initially losing money and leads.
- The quality of SHGs (Self-Help Groups) has been questioned due to the rapid expansion of the SHG-Bank Linkage Program.
- Geographic Constraints – Around 60% of MFIs think that geographic factors make it difficult to engage with clients in remote places, posing a problem for the organization's growth and expansion.
- Scalability Issues – Smaller microfinance systems sometimes struggle to maintain profitability and performance in these markets due to strong growth rates seen by Financial Institutions as a result of getting service delivery correctly.
- Diverse business models – Supporting many features and loan activities is complex and expensive.
- High Transaction Costs – Microfinance institutions have a significant transaction cost burden.
- Safety and KYC issues: Customers served by Microfinance instructions frequently need more official identification or the ability to provide actual security, making it extremely difficult for institutions to offer banking services.
- Budget constraints — Most MFIs are unable to make big upfront investments.

- Funding: Banks often feature various products and an assured deposit structure.
- Over borrowing: The largest danger confronting the microfinance industry today is borrowers' proclivity to over borrow.
- Unfavourable policies: While microfinance institutions have been lucrative in India, they have faced laws and populist politics that have been detrimental.
- Missing of Targets: MFIs frequently overlook the urban poor in favour of concentrating their efforts on the rural poor.
- Loan Default: Risk management remains ineffective.
- Lenders charge high-interest rates: MFIs charge a high rate of interest on loans ranging from 12 to 30 per cent of the principal amount.

12.13. CRITICISM OF MICRO FINANCE

While microfinance has been praised for its potential to alleviate poverty and empower marginalized communities, it has also faced significant criticism. Here are some of the key points of contention:

1. High Interest Rates

Despite being positioned as an alternative to exploitative moneylenders, many microfinance institutions (MFIs) charge relatively high interest rates compared to traditional banks. Critics argue that these rates can be prohibitive for the very poor, leading to a cycle of debt rather than alleviating poverty.

2. Over-Indebtedness

In some regions, the aggressive marketing and proliferation of MFIs have led to borrowers taking multiple loans from different sources. This over-borrowing can result in unsustainable debt levels, causing severe financial stress for borrowers.

3. Focus on Profit Over Social Mission

There is concern that the commercialization of microfinance has shifted the focus from its original social mission to profit-making. Some MFIs, particularly those that have undergone rapid growth or attracted significant investor interest, may prioritize financial returns over the welfare of their clients.

4. **Impact on Poverty Alleviation**

The evidence on the effectiveness of microfinance in reducing poverty is mixed. Some studies suggest that microfinance has limited impact on income levels and does not significantly improve long-term economic well-being. Critics argue that small loans are often insufficient to transform the economic status of poor households.

5. Lack of Financial Literacy

Many microfinance clients lack adequate financial literacy, which can lead to poor financial decisions. Without proper guidance and education, borrowers may not use the funds effectively, which can undermine the potential benefits of microfinance.

6. Pressure and Coercion in Repayment

Reports of coercive collection practices by some MFIs have surfaced, where borrowers are pressured into repaying loans under threat of social ostracization or harassment. Such practices can lead to severe distress among borrowers, including extreme cases of suicide.

7. Exclusion of the Poorest

Despite the aim to serve the poorest, MFIs often end up excluding the most vulnerable individuals due to their higher risk profiles. These individuals may lack the necessary collateral or credit history, making them unattractive to MFIs focused on repayment rates.

8. Short-Term vs. Long-Term Solutions

Critics argue that microfinance provides only short-term relief rather than addressing the structural issues underlying poverty. Sustainable economic development requires investment in infrastructure, education, and health, which microfinance alone cannot provide.

9. Inequality in Benefits

There is evidence to suggest that the benefits of microfinance are not evenly distributed. Certain groups, such as men or those with existing resources and networks, may benefit more than others, leading to increased inequality within communities.

10. Dependency on Loans

Microfinance can create a dependency on loans, where businesses and individuals continuously borrow to sustain operations rather than generate enough profit to become self-sufficient. This dependency can hinder genuine economic progress and growth.

12.14. CHIT FUNDS

Micro finance institutions are sometimes referred to as chit funds. These are also recognised as Chitty, chit, and other similar instruments. It's important to note that India has over 10,000 chit funds registered with the government. Chit funds usually have two active positions or designations among them. Member and delegate are two examples of such positions or designations. A chit fund arrangement demands that a certain sum of money is invested daily by various members. The money is repaid to the customers with interests after a given period. Chit funds aid with the accumulation of small savings from a large number of people, culminating in a large total. Chit fund schemes are organized by financial institutions, informal money market players like traders, money lenders or private financiers. Schemes are also floated by groups of friends, relatives or neighbours. There are three types of chit funds that you can invest in:

"A chit fund is a form of revolving investment arrangement in which various people, such as friends, relatives, neighbours, and family members, choose to contribute a certain amount of money over a certain period."A chit fund organisation's activity is based on the following business model: to start a chit fund business, locating prospective participants, enrolling members in a chit, gathering donations, holding chit auctions, circulating money, and keeping books. Chit fund firms raise profits by collecting a set percentage of the overall donation from participants as a charge for administering the chit fund scheme.

Chit fund schemes are financial instruments wherein a group of members contributes a fixed amount regularly, thus creating a pool of funds. The corpus is awarded to a member via periodic auction, offering them a lump sum amount. Chit Fund Schemes serve as a savings and borrowing platform, providing financial flexibility. A chit-fund company facilitates and manages these schemes, overseeing the collection of contributions, conducting auctions, and ensuring regulatory compliance.

12.15. HOW TO INVEST IN THE CHIT FUND SCHEMES

Step 1: Learn the Basics

Before diving into Chit Funds, understand the concept, benefits, and risks. Familiarize yourself with regulations for a solid foundation.

Step 2: Set Your Goals

Define financial goals and assess Chit Funds' alignment. Whether wealth creation or specific milestones, clarity guides your strategy.

Step 3: Choose a Trusted Company

Select a reputable Chit Fund company. Look for proven track records, credibility, and transparency.

Step 4: Do Your Research

Delve into terms, and compare interest rates, fees, and repayment options. A meticulous analysis empowers informed choices.

Step 5: Join a Chit Group

Select a reputable company, joins a fitting Chit Group, and understands contribution dynamics.

Follow these steps, emphasize research, and confidently navigate Chit Funds.

12.15. BENEFITS OF CHIT FUNDS

Here are some of the benefits of a chit funds:

1. Flexibility - There's a lot of flexibility in terms of the amount of contributions towards chit funds, as well as the timing and size of the prize or loan disbursements.

2. Affordability -Chit funds typically have low contribution requirements, making them an affordable option for people with limited income.

3. Convenience -Chit funds are often conducted entirely online, which makes it easy for participants to manage their accounts and make contributions.

4. Credit -Chit funds can provide an alternative source of credit for people who may not qualify for traditional loans due to lack of collateral or credit history.

5. Investment Opportunity -Chit funds can also be used as a way to save and invest money over the long term, as the value of the fund grows with each contribution.

12.16. TYPES OF CHIT FUNDS

Chit funds are one of the most popular return-generating saving schemes in India. It is a financial arrangement in which a group of people contribute money to a fund on a regular basis. Each member of the group is eligible to receive a cash prize or loan, usually on a rotating basis. Chit funds are organised and managed by a chit fund company, which scrutinises, supervises, and manages chit fund schemes in accordance with Section 2(b) of the Chit Fund Act, 1982.

Chit Funds are highly regarded in India as effective savings schemes known for yielding returns. Governed by the Chit Fund Act of 1982, these entities operate under stringent state government regulations. Membership in a Chit Fund scheme offers individuals the opportunity to secure a rotating cash prize or loan. This article provides an in-depth analysis of the ten leading chit-fund schemes, exploring their advantages and key aspects in detail.

State-run Chit Funds:

This category includes chit funds that are operated by state governments. Since these funds are state operated, the chances of losses are minimal and businesses' processes are transparent. Mysore Sales International Limited (MSIL) and Kerala State Financial Enterprises (KSFE) are examples of state-run chit funds.

Registered Chit Funds:

These are privately-run chit funds, registered with the Registrar of Chits and regulated by the state governments under the directives of the Reserve Bank of India guided by the Chit Fund Act of 1982. These are considered as safe, as they are regulated under a legal framework and hence the risk is covered completely.

Unregistered Chit Funds:

These types of chit funds are operated by groups of friends, relatives, peer groups or colleagues. Investment in unregistered funds is considered risky as they do not come under the purview of any law. In spite of the personal risk associated with participating in an unregistered chit fund, these are very common across India as they are usually formed by close groups of associates and mostly all subscribers are known to each other. However, participation in these funds should be avoided as the risk grows with the size of money involved. Also, the organizers' money management discipline drives the risk further.

12.17. ADVANTAGES OF INVESTING IN CHIT FUNDS

When it comes to investing your hard earned money, it is imperative to weigh the pros and cons. If you choose chit funds, it should be because they suit your requirements and you understand how it works.

- Chit fund is a versatile financial product because it works as both an investment and a borrowing tool: when you pay the monthly installment, you invest that money and when you win the auction, you borrow against the subsequent installments (future savings).
- Chit funds let you borrow a lump sum amount without providing any formal collateral, as opposed to banks or other financial institutions.
- The rate of interest is also much lower than what a bank would offer.
- From the tax point of view, while the overall income is subject to income tax, the dividends earned per month are neither taxable nor tax deductible. Any losses can be claimed as business losses.
- Chit funds are easy to join, especially if your social collateral is high and money obtained can be used in any way you want: for travel, for medical or business expenses, marriage, education or any other financial emergency.
- At the societal level, they promote a culture of saving as each member is expected to contribute a fixed amount regularly towards the fund.
- To some extent, chit funds level the playing field by providing access to money for financially excluded communities. This is an advantage in a country like India where the bulk of the population works in the informal sector and obtaining a formal loan is difficult for an average person.

12.18. RISKS INVOLVED INVESTING IN CHIT FUNDS

Chit funds also suffer from a bad reputation because they have been misused in the past to scam naïve investors or run ponzi schemes. Popularly there are two big instances at the national level where people have been defrauded in the name of chit funds. Lack of financial literacy amongst the general populace means that unscrupulous people can promise huge returns on investments in the name of chit funds which they have no intentions of fulfilling. They may also use administrative loopholes and gaps in policy to dupe the gullible. Investing in unregistered chit funds is perhaps the biggest risk that you can take with your money. Unregistered chit funds do not fall under the purview of any law or regulated the way

registered chit funds are. The organizers cannot be held to any promises made by them and may misuse the pooled funds.

Unregistered chit funds are usually run by people who are known to each other but the organizer may decide to expand the group without checking the creditworthiness of the members leading to a trust deficit amongst the members.

There is also the risk of members defaulting on payments, especially if they have already won a previous round of auction.

A registered chit group has to deposit 100% of the chit value with the Registrar of Chits prior to the commencement of the chit scheme. This deposit is refunded on the successful completion of the chit life cycle. But to avoid paying this amount, a company that runs registered chit funds may run groups that are unregistered. As an investor you have to specifically ensure that the fund that you are investing in is registered so that your money falls under the regulatory safety net.

12.19. SUMMARY

In summary, microfinance in India plays a pivotal role in fostering financial inclusion, reducing poverty, and empowering marginalized communities. By providing access to financial services, it enables individuals to improve their economic conditions, support their families, and contribute to the broader socio-economic development of the nation. While microfinance has the potential to contribute positively to financial inclusion and poverty alleviation, it is not a panacea. The criticisms highlight the need for a more balanced and holistic approach, integrating microfinance with other developmental initiatives such as education, healthcare, and infrastructure development. Addressing these issues requires better regulation, enhanced borrower education, and a renewed focus on the social mission of microfinance to ensure that it truly benefits the most disadvantaged sections of society.

Investing in a registered chit fund is a good financial decision for investors as their maturity period is usually short and the subscription amount is small making them easily affordable. The investment can be designed to suit individual needs. Paying regular installments will help you bring discipline to your finances and it can be a reliable source of funds in an emergency. Chit funds are a popular investment option in the rural areas. However, you need to do considerable research before investing in a chit fund. There have been cases of illegal chit firm houses sweeping off lakhs of money from investors. Consider all these risks before investing in a chit fund scheme.

12.20. KEY WORDS

ATM - AUTOMATED TELLER MACHINE

Whether you want to withdraw cash, deposit cash or undergo any important fund transfers immediately, it is not exactly convenient to always visit the bank branch and wait in long queues to perform such quick and easy transactions.

PERMANENT ACCOUNT NUMBER – PAN

Permanent Account Number abbreviated as PAN is a unique 10-digit alphanumeric number issued by the Income Tax Department to Indian taxpayers.

CIF NUMBER MEANS

Customer Identification File, or CIF number in general, is an electronic, 11 digit number that contains all the personal information of the customers of the bank.

MERCHANT BANKING

Merchant banking is a professional service provided by the merchant banks to their customers considering their financial needs, for adequate consideration in the form of fee.

CREDIT AGENCY

A credit agency is a for-profit firm that collects information regarding the debts of individuals and companies and assigns a numerical value called a credit score that indicates the creditworthiness of the borrower.

INFLEXIBLE EXPENSE

An inflexible expense is an expense that cannot be skipped or adjusted by a company or an individual.

SHOW ROOMING

Show rooming refers to the practice of checking out a product in a retail store before buying it from online retailers.

12.21. SELF-ASSESSMENT QUESTIONS

Essay type questions

1. What is Micro Finance and write the role and importance of micro finance in India.
2. What are objectives of Micro Finance and discuss the challenges faced by micro finance institutions in India.
3. What are Chit Funds and describe the different types of chit funds working in India?
4. What are the Benefits of Chit Funds? And how to invest in them?

Short type questions

1. How does Micro Finance institutions working in India?
2. Write the history and evolution of micro finance in India.
3. How Does a Chit Fund Work?
4. What are the advantages of chit funds?

12.22.SUGGESTED READINGS

1. Daryl Collins, Jonathan Morduch, Stuart Rutherford, and Orlanda Ruthven: Portfolios of the Poor: How the World's Poor Live on $2 a Day, Princeton University Press, NJ, 2009.
2. Malcolm Harper: Microfinance: Evolution, Achievements, and Challenges, Practical Action Publishing, Rugby, UK, 2010.
3. R. Venkatachalam: Chit Funds in India, Snow White Publications Pvt. Ltd. Mumbai, 2017.
4. Chit Funds Act, 1982, Kamal Publishers, Lawman Series. New Delhi. 2022.

Dr. P. Mercy Kumari

LESSON – 13
ROLE OF PAYMENT BANKS IN INDIA

Aims and Objectives:

After reading this lesson the student would know the following aims and objectives of:

- To understand the features of payment banks in India
- To know the regulations of payment banks in India
- To understand the number of payment banks working in India
- To know the difference between payment banks and commercial banks

Structure

13.1. Introduction
13.2. Objectives of payment banks
13.3. Features of payment banks
13.4. History of payment banks in India
13.5. Regulations of payment banks
13.6. List of payment banks in india
13.7. Difference between payment banks and commercial banks
13.8. Summary
13.9. Key words
13.10. Self-assessment questions
13.11. Suggested readings

13.1. INTRODUCTION

Payments Bank was founded on the Nachiket Mor Committee's suggestions to run on a smaller scale with little credit risk. The goal is to promote financial inclusion by providing banking and financial services to unbanked and under banked areas, migrant workers, low-income households, small entrepreneurs, etc. They are registered under the Companies Act of 2013 but supervised by the Banking Regulation Act of 1949, RBI Act of 1934, Foreign Exchange Management Act of 1999, Payment and Settlement Systems Act of 2007, and others. Payments banks are a new model of banks, conceptualised by the Reserve Bank of India (RBI), which cannot issue credit. These banks can accept a restricted deposit, which is currently limited to ₹200,000 per customer and may be increased further. These banks cannot issue loans and credit cards. Both current account and savings accounts can be operated by such banks. Payments banks can issue ATM cards or debit cards and provide online or mobile banking.

In August 2015, the Reserve Bank of India (RBI) provisionally approved the establishment of payment banks in India for 11 entities, among which was the Department of Posts. This move was part of a broader initiative to enhance financial inclusion across the country, providing a platform for small businesses, low-income households, and others to access banking services more conveniently. Airtel Payment Bank led the way as the first to launch among the newly established payment banks, setting a precedent in this innovative banking sector. Following its lead, several other entities such as Paytm Payment Bank, Fino Payments Bank, and Aditya Birla Payments Bank also commenced operations, contributing to the diverse landscape of payment banking in India and expanding the reach of financial

services to underserved segments of the population. Currently, there are 6 payment banks operating in India which were initially 11.

DEFINITION:

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

13.2. OBJECTIVES OF PAYMENTS BANKS

According to the Reserve Bank of India (RBI) data, almost 60% of the people of the country are still not connected with the banking sector. This includes many lower-income people; who live in rural areas of the country, work in unorganized sector and often migrate to cities/abroad in the search of a job.

The main objectives of setting up of payments banks are to ensure the financial inclusion by providing payments/remittance services to migrant labour workforce, opening up small savings accounts of small business holders, low-income households, workers of the unorganised sector.

13.3. FEATURES OF PAYMENTS BANKS:

Payments banks will do almost all the work that is currently being done by commercial banks, but the payments banks will work under certain restrictions like;

1. As the commercial banks, the payment banks will also accept the money of the people as a deposit but the limit is fixed, which means the payments banks can accept deposits up to a maximum of Rs. 1 lakh from a customer.
2. Payments banks; will be entitled to issue ATM or debit cards to their customers but cannot issue a credit card.
3. Payments banks; will be authorised to open both savings and current accounts of their customers.
4. Payments banks cannot provide loans or lending services to customers.
5. Payments banks cannot accept deposits from the Non-Resident Indians (NRIs). It means; the people of Indian origin who have settled abroad cannot deposit their money in the payment banks.
6. Payments banks will be allowed to make personal payments and receive remittances from the cross border on the current accounts.
7. Payments banks will have to deposit the amount in the form of a Cash Reserve Ratio (CRR) with RBI as other commercial banks do.
8. Payments Banks will have to invest a minimum of 75% of its demand deposits in government treasury/securities bills with maturity up to one year and hold a maximum of 25 %in currents and fixed deposits with other commercial banks for operational purposes.
9. Payment banks can provide the Facility of utility bill payments to its customers and the general public.
10. Payments banks cannot open subsidiaries to undertake Non-Banking Financial Services activities.

11. Payments bank; with approval from RBI, can work as a partner with other commercial banks and also can sell mutual funds, pension products, and insurance products.
12. Payments banks must use the word "Payments Bank" in their names to look different from other banks.
13. Payments banks will be allowed to provide internet banking and mobile banking facility to their customers.
14. Payments banks can become a business representative of any other bank, but it will have to comply with the guidelines of the Reserve Bank of India.
15. The payments banks can accept remittances to be sent to or receive remittances from multiple banks through payment mechanism approved by RBI, such as RTGS / NEFT / IMPS.

13.4. HISTORY OF PAYMENT BANKS IN INDIA

On 23 September 2013, Committee on Comprehensive Financial Services for Small Businesses and Low Income Households, headed by Nachiket Mor, was formed by the RBI. On 7 January 2014, the Nachiket Mor committee submitted its final report. Among its various recommendations, it recommended the formation of a new category of bank called payments bank. On 17 July 2014, the RBI released the draft guidelines for payment banks, seeking comments for interested entities and the general public. On 27 November, RBI released the final guidelines for payment banks

In February 2015, RBI released the list of entities which had applied for a payments bank licence. There were 41 applicants. It was also announced that an external advisory committee (EAC) headed by Nachiket Mor would evaluate the licence applications. On 28 February 2015, during the presentation of the Budget it was announced that India Post will use its large network to run payments bank. The external advisory committee headed by Nachiket Mor submitted its findings on 6 July 2015. The applicant entities were examined for their financial track record and governance issues. On 19 August 2015, the Reserve Bank of India gave "in-principle" licences to 11 entities to launch payments banks. The "in-principle" license was valid for 18 months within which the entities must fulfil the requirements and they were not allowed to engage in banking activities within the period. The RBI will grant full licenses under Section 22 of the Banking Regulation Act, 1949, after it is satisfied that the conditions have been fulfilled.

March 2019 witness, Paytm account for over 19% of all mobile-banking transactions while Airtel's Payments Bank contributed more than 5% to the 867 million transactions made during the month. In contrast, State Bank of India (SBI), the largest lender in the country by assets, recorded 145 million transactions, accounting for under 17%.The only banks ahead of Airtel Payments Bank are SBI and the three largest private-sector banks – HDFC Bank, ICICI Bank and Axis Bank. Indeed, ICICI Bank saw close to 60 million mobile-banking transactions in March 2019 though it was just a whisker ahead of Airtel, with under 7% of the market. Paytm Payments Bank and Airtel Payments Bank together command over 88% of the deposits in payment banks in India in 2018.

According to the Reserve Bank of India's report on ‘Trend and progress of Banking in India 2017-2018', the payment banks reported losses in the financial year 2017-2018, after a weak performance in the FY 2016-17.

13.5. REGULATIONS OF PAYMENT BANKS

The minimum capital requirement is Rs.100 crore. For the first five years, the stake of the promoter should remain at least 40%. Foreign share holding will be allowed in these banks as per the rules for FDI in private banks in India. The voting rights will be regulated by the Banking Regulation Act, 1949. The voting right of any shareholder is capped at 10%, which can be raised to 26% by the Reserve Bank of India. Any acquisition of more than 5% will require approval of the RBI. The majority of the bank's board of directors should consist of independent directors, appointed according to RBI guidelines.

The bank should be fully networked from the beginning. The bank can accept utility bills. It cannot form subsidiaries to undertake non-banking activities. Initially, the deposits will be capped at ₹100,000 per customer, but it may be raised by the RBI based on the performance of the bank. Payment Banks are not permitted to lend to any person including their directors. 25% of its branches must be in the unbanked rural area. The bank must use the term "payments bank" in its name to differentiate it from other types of bank. The banks will be licensed as payments banks under Section 22 of the Banking Regulation Act, 1949, and will be registered as public limited company under the Companies Act, 2013.

13.6. LIST OF PAYMENT BANKS IN INDIA

On November 27, 2014; the Reserve Bank of India has granted “in-principle” approval to the following 11 applicants to set up payment banks in the country. As of now, only 6 banks are working namely;

1. Airtel Payments Bank Limited
2. India Post Payments Bank Limited
3. Fino Payments Bank Limited
4. Paytm Payments Bank Limited
5. NSDL Payments Bank Limited
6. Jio Payments Bank Limited

PAYMENT BANKS IN INDIA

Name of Bank	Headquarters	Date of Establishment	Features	Owned By
Airtel Payment Bank	New Delhi	Jan-17	Joint venture between Bharti Airtel and Kotak Mahindra Bank	Anubrata Biswas
Fino Payment Bank	Mumbai, Maharashtra	Apr-17	Promoted by Fino Paytech, ICICI Group, and Bharat Petroleum	Rishi Gupta
India Post Payment Bank	New Delhi	Sep-18	Operated by the Department of Posts, Ministry of Communications	J. Venkatramu
Paytm Payment Bank	Noida, Uttar Pradesh	2017	Operates under One97 Communications, the parent company of	Vijay Shekhar Sharma

			Paytm	
NSDL Payment Bank	Mumbai, Maharashtra	Oct-18	Promoted by National Securities Depository Limited	Mr Ashutosh Singh
Jio Payment Bank	Navi Mumbai, Maharashtra	2018	Joint venture between Reliance Industries and State Bank of India	Reliance Industries (70%) State Bank of India (30%)

1.Airtel Payment Bank

Bharti Airtel, India's largest telecom provider, launched Airtel Payments Bank in January 2017 to promote the government's promised cashless transformation. The Airtel Payments Bank is a distinct bank dedicated to Transforming the Way India Banks by reinventing every process, product, and service involved with banking with the customer's needs at the centre of every effort. Its methods are designed to make banking easier and more straightforward for all customers. They are empowering clients by expanding the availability of their services, whether online or in-person. And they are working hard to make the banking experience more courteous for all of our clients. Airtel Payments Bank's mission is to render banking accessible, simple, and inclusive to all Indians.

2. Fino Payment Bank

On June 23, 2007, the bank was established as the Fino Fintech Foundation. Following the surrender of the licence under Section 8 of the Companies Act 2013, it was renamed to Fino Fintech Private Limited, and a new certificate of incorporation was issued on December 15, 2015. Following the shift of the banking institution to a public corporation, the official title of the institution was modified on 03 February 2017 to Fino Fintech Limited. On April 4, 2017, the official title of the financial institution was renamed to Fino Payments Bank Limited after receiving approval from the RBI. On June 30, 2017, the bank opened its doors for business. The bank is a completely owned subsidiary of FINO PayTech Ltd, which provides business and banking-specific platform-based solutions and financial inclusion services. The bank offers an extensive variety of financial products and services to the rural poor, as well as those from underprivileged and unserved classes.

3. India Post Payment Bank

India Post Payments Bank (IPPB) was established under the Department of Post, Ministry of Communication, with the Government of India owning 100% of the stock. On 30 January 2017, IPPB was launched as a pilot project in Ranchi (Jharkhand) and Chhattisgarh, with the goal of having presence across India by the fiscal year 2018-2019. Through a network of a single location and 649 banking outlets managed by Business Correspondents, IPPB has expanded its reach across India, covering post offices.

4. Paytm Payment Bank

Paytm Payments Bank (PPBL) is an Indian payments bank headquartered in Noida that was created in 2017. It is a subsidiary of the mobile payment business paytm. It was

granted a licence by Reserve Bank of India to operate a payments bank in the same year, and it began operations in November 2017. The RBI granted the bank scheduled bank status in 2021. Vijay Shekhar Sharma owns 51% of the company, while One97 Communications owns 49%.

5. NSDL Payment Bank

The headquarter of the NSDL Payments Bank is located in Mumbai. The organisation commenced its activities in October of 2018. NSDL Payments Bank Limited is a non-governmental organisation based in India. The legal classification of this public company is "company limited by shares.

6. Jio Payment Bank

Jio Payments Bank Limited, an Indian payments bank that commenced operations in 2018, operates as a subsidiary of Reliance Industries' Jio Platforms. The Reserve Bank of India (RBI) granted Reliance Industries preliminary sanction to establish a payments bank in accordance with the Banking Regulation Act of 1949. Then, in November 2016, in collaboration with the State Bank of India, it established Jio Payments Bank Limited. Jio Payments Bank Limited is a State Bank of India and Reliance Industries joint venture in the proportions of 70:30.

ACTIVITIES THAT CAN BE PERFORMED BY PAYMENT BANKS

1. **Deposits:**

Payment banks accept ₹2,000,000 deposits. It accepts savings and current account demand deposits.

2. **Government Securities:**

Deposits can only be invested in secure government securities as Statutory Liquidity Ratio. This must be 75% of demand deposit. Other designated commercial banks will hold 25% as time deposits.

3. **Cross Border Remittances:**

On current accounts, payments banks can make personal payments and receive cross-border remittances.

4. **Issue Debit Cards**:

Payment banks issues debit cards.

ACTIVITIES THAT CANNOT BE PERFORMED BY PAYMENT BANKS

1. Payment Bank Can Not Lend:

Payment banks cannot lend since they have an RBI 'differentiated' bank licence.

2. **Cannot Issue Credit Cards:**

No payment banks have the authority issue credit cards.

3. **Payment Banks Don't Accept Time Deposits:**

It doesn't accept NRI or time deposits.

4. **Subsidiaries:**

It cannot create non-banking financial subsidiaries.

13.7. DIFFERENCE BETWEEN PAYMENT BANKS AND COMMERCIAL BANKS

BASIS	PAYMENT BANKS	COMMERCIAL BANKS
Scope of Activities	Payment banks typically concentrate on offering basic financial services, such as receiving deposits and carrying out money transfers. They are prohibited from providing loans or issuing credit cards. Payment banks aim to facilitate financial inclusion by targeting individuals and communities that do not have access to traditional banking services or have limited access to them.	Commercial banks provide diverse financial services such as deposit acceptance, loan provision, credit card issuance, and a variety of investment products. Payment banks have a narrower range of activities in comparison to them.
Ownership and Regulation	Payment banks are subject to regulation by the central bank or financial regulatory authorities of the country. Ownership of the entity might be either private or corporate.	Commercial banks have diverse ownership arrangements, like private, public, or a hybrid composition. They are governed by extensive rules to preserve stability and safeguard the interests of customers.
Interest Rates	Payment banks typically provide interest on deposits, but at potentially lower rates compared to commercial banks. Their money is generated by collecting fees and charges on transactions.	Commercial banks provide a variety of interest rates for deposits and loans, which vary based on the specific account or loan. They create revenue through the interest spread, which is the difference between the interest accrued on loans and the interest disbursed on deposits.

BASIS	PAYMENT BANKS	COMMERCIAL BANKS
Credit Card	They are prohibited from issuing credit cards	They can issue credit cards
Primary Focus	The main emphasis is on the transfer of funds and remittances.	Remittances offering is not the main focus of Commercial banks
Balance Limits	The maximum balance limit is ₹1 lakh in savings account.	There is no limit on deposit account balances.

Payments banks will increase financial inclusion while also improving the country's poorer sections, enabling them to take part in the country's economic growth.

13.8. SUMMARY

A payment bank is a type of banking institution in India, designed primarily to enhance financial inclusion by making banking services accessible to all segments of society, especially those previously excluded from the banking system. They specialize in offering basic banking operations like savings accounts, payments, and remittance services targeting low-income individuals, small businesses, and others with limited banking needs. The setting up of the payments banks will not only increase the financial inclusion in the country but also strengthen the weaker section of the country so that they can also give their contribution in the economic development of the country.

13.9. KEY WORDS

Payment Banks: Payment Banks are a type of bank in India that primarily focus on providing basic banking services such as accepting deposits and facilitating money transfer services. They are differentiated from traditional banks by their limited scope of operations.

Financial Inclusion: Payment Banks play a crucial role in promoting financial inclusion by providing banking services to underserved and unbanked segments of the population, especially in rural and remote areas.

Deposit Services: Payment Banks accept deposits from individuals and small businesses, encouraging savings habits and providing a secure place to store funds.

Remittance Services: These banks facilitate domestic and international money transfers, enabling individuals to send and receive funds quickly and securely, even in regions with limited banking infrastructure.

Mobile Banking: Payment Banks heavily leverage mobile technology to offer banking services, allowing customers to access their accounts, make transactions, and manage finances conveniently through mobile applications.

Agent Network: Payment Banks often establish extensive agent networks, including local shops and businesses, to reach customers in remote areas where establishing physical branches may not be feasible.

Digital Payments: With a focus on digital transactions, Payment Banks promote the adoption of cashless payment methods such as mobile wallets, UPI (Unified Payments Interface), and digital cards, contributing to India's goal of becoming a less cash-dependent economy.

Regulatory Compliance: Payment Banks operate under the regulatory framework established by the Reserve Bank of India (RBI), ensuring compliance with regulations related to capital adequacy, customer protection, and risk management.

13.10.SELF-ASSESSMENT QUESTIONS

Essay type questions

1. What are payment banks and describe the difference between payment banks and commercial banks.
2. What are the objectives of payment banks and write the number of payment banks working in india

Short type questions

1. What are the features of payment banks?
2. What are the Regulations of payment banks in India?

13.11.SUGGESTED READINGS

1. Sachin Mittal: Payment Banks in India: Evolution, Regulation, and Challenges Springer Publications, Singapore, 2019.
2. Manoj Kumar Gupta: Payment Banks in India: Regulatory Aspects and Challenges, Excel Books Publications, New Delhi, 2018.
3. R.K. Uppal: "Payment Banks: The Revolution in Banking", New Age International Publisher, New Delhi, 2017.
4. Piyu Verma: "Payment Banks: Challenges and Opportunities", McGraw-Hill Education, New York, 2018.

Dr. P. Mercy Kumari

LESSON – 14
NON BANKING FINANCIAL INSTITUTIONS IN INDIA

Aims and Objectives:

After reading this lesson the student would know the following aims and objectives of:

- To understand meaning and functions of NBFCS
- To know the types and regulations of NBFCS
- To understand problems and remedies encountered by NBFCS
- To know the types and benefits of EMI

Structure

14.1 Introduction
14.2 NBFCS - meaning and definition
14.3 How is NBFCS are different from banks
14.4 Types of NBFCS
14.5 Functions of NBFCS
14.6 Financial services offered by NBFCS in India
14.7 Governance authority and registration requirements
14.8 Guidelines by RBI for non-banking financial company in India
14.9 Regulation related to deposit acceptance
14.10 Problems and challenges encountered by NBFCS
14.11 Remedies to the challenges encountered by NBFCS
14.12 EMI (equated monthly installment)
14.13 Summary
14.14 Key words
14.15 Self-assessment questions
14.16 Suggested readings

14.1. INTRODUCTION

An NBFC stands for Non-Banking Financial Company, and it's a financial company which is registered under the Companies Act, 1956 and 2013, involved in the business of advances or Credits or loans, acquisition of stocks or bonds or debenture or shares or securities issued by Local Authority or Government of India or other marketable securities such as leasing, chit business, nature, hire-purchase but does not include any organization or any institution whose principal business is that of industrial activity, agricultural activity, sale or purchase of any goods and services and sale or construct or purchase of an immovable property. A non-banking organization that is a company and has the principle business of getting deposits under any arrangement or plans in a single lump sum or installments by way of contributions or another manner is also an NBFC (Non-Banking Financial Company). Non-Banking Financial Companies (NBFCs) are an indispensable part of the Indian financial market and play a considerable role in the Indian economy. As their name suggests, their nature of operations is altogether different from that of banks. They provide services to mainly rural and semi-urban sectors.

In the last few years in India, the financial sector has observed a rapid transformation, and NBFCs or Non-Banking Financial Companies plays a vital role in that growth. Non-

Banking Financial Companies in India continued to gain huge success in the financial sector, and its involvement has surpassed the contribution by the traditional banks. Henceforth, NBFC Registration sound like a favourable scheme for all the entrepreneurs in India. A Non-Banking Financial Company (NBFC) is a company registered under the Companies Act, 1956 or the Companies Act, 2013, NBFCs, or non-banking financial companies are financial institutions that provide a wide range of banking services and financial products, similar to traditional banks, but they do not hold a banking license. These companies are an integral part of the financial system and play a crucial role in providing credit and financial services to various sectors of the economy.

NBFCs are financial institutions engaged in providing various financial services and products, with the principal business of receiving deposits under an arrangement in one lump sum, in installments by way of contributions or in any other manner. But unlike banks, they cannot accept deposits from the general public and are not involved in the general banking business. These institutions provide varied services to their customers.

14.2. NBFCS - MEANING AND DEFINITION

"NBFC," is defined under section 45-I (f) of the Act, as under "NBFCs" means:

(i) A financial institution which is a company;

(ii) A non banking institution which is a company and which has as its principal business the receiving of deposits, under any scheme or arrangement or in any other manner, or lending in any manner;

(iii) Such other non-banking institution or class of such institutions, as the bank may, with the previous approval of the Central Government and by notification in the Official Gazette, specify.

"The company will be treated as a non-banking financial company (NBFC) if its financial assets are more than 50% of its total assets (netted off by intangible assets) and income from financial assets is more than 50% of the gross income. Both these tests are required to be satisfied as the determinant factor for principal business of a company." According to the Reserve Bank (Amendment Act) 1997, "A NBFC means a financial institution which is a company; A non-banking institution which is a company and which has as its principal business the receiving of deposits under any scheme of arrangement or in any other manner or lending in any manner; such other non-banking institution or class of such institutions as the Bank may with the previous approval of the Central Government specify". The definition excludes financial institutions besides institutions which carry on agricultural activities as their principal business.

14.3. HOW IS NBFCS ARE DIFFERENT FROM BANKS

NBFCs perform normal lending and investment business like banks; however, there are three major differences between banks and NBFCs, as follows:

- NBFC cannot accept demand deposits,
- NBFCs are not allowed to issue cheques drawn facility and also cannot follow regular payment and settlement system,
- NBFC depositors cannot avail themselves of the facility of deposit insurance,
- Diverse financial services provided by NBFCs,
- Loans under different categories, such as personal, home, vehicle, and gold,

- Microfinance for small industries,
- Leasing and hire-purchase services,
- Credit cards and services,
- Insurance services,
- Investment services, and
- Asset management services.

14.4. TYPES OF NBFCS

The different types of NBFCs are:

1. **Asset Finance Company (AFC)-** These provide finance to purchase physical assets such as automobiles, vehicles, lathe machinery, generator sets, earthmoving and material handling equipment, etc. to support productive and economic activities.
2. **Investment Company (IC) -** They invest in various securities such as stocks, bonds and debentures.
3. **Loan Company (LC) -** These NBFCs provide loans or advances to individuals and businesses.
4. **Infrastructure Finance Company (IFC)-** These companies provide long term finance to infrastructure schemes and satisfy the following criteria:
    1. Utilise at least 75% of its total assets in infrastructure loans.
    2. The minimum NOF required is Rs. 300 crore.
    3. The credit rating should be at least an A or equivalent.
    4. Capital-to-risk weighted assets ratio (CRAR) of 15%.
5. **Infrastructure Debt Fund- Non- Banking Financial Company (IDF-NBFC)-** These NBFCs provide long term debt financing for infrastructure projects. IDF-NBFC raises resources through the issuance of Rupee or Dollar denominated bonds of a minimum 5 year maturity. Only Infrastructure Finance Companies (IFC) can sponsor IDF-NBFCs.
6. **Non-Banking Financial Company- Micro Finance Institution (NBFC-MFI)-** These NBFCs are non deposit taking finance companies with at least 85% of their assets in the nature of qualifying assets and the minimum NOF is 5 crores.
7. **Non-Banking Financial Company-Factors (NBFC-Factors)-** Their main line of business is factoring, which refers to financial transactions in which the company sells its bill receivables to third parties at a discounted rate.
8. **Mortgage Guarantee Companies (MGC)-** This is another kind of NBFC where minimum 90% of the business turnover or minimum 90% of the gross income pertains to mortgage guarantee business with NOF Rs. 100 crores.
9. **NBFC- Non-Operative Financial Holding Company (NOFHC)-** The promoter or promoter group will hold the bank as well as all other financial services companies that are regulated by the RBI or other financial sector regulators, to the extent permissible under the applicable regulatory prescriptions.

14.5. FUNCTIONS OF NBFCS

The functions of NBFCs are:

- The majority of NBFCs provide funds for infrastructure projects, including Railways, metro construction, Flyovers, Airports, Real estate, etc., which are considered the backbone of every developing country like India.

- Another major role is played in Hire Purchase services, through which the seller only delivers goods to the buyer and transfers ownership of the goods later, once full payment is made for the goods.
- They deal with Retail funding for many companies, which includes a variety of short-term loans against movable properties such as shares, gold, and property for various business purposes.
- They are also involved in the asset management function, where fund managers invest in the share market through pooling of funds from small investors and manage them to provide high rates of return.
- They fulfill the working capital requirements of companies for operating day to day business.
- Venture Capital funding is one of the major functions where they invest in small businesses at their initial stages to act as guarantors and help earn high profits from these projects.
- They provide finance and support Micro Small Medium Enterprises (MSME) registered under various schemes run by the Government to promote social and economic welfare for the country.

14.6. FINANCIAL SERVICES OFFERED BY NBFCS IN INDIA

Non-Banking Financial Institutions (NBFIs), also known as Non-Banking Financial Companies (NBFCs) in India, offer a wide array of financial services that cater to various segments of the economy. These services are instrumental in bridging the gap between the formal banking sector and the underserved segments of the population. Below are some of the key financial services provided by NBFIs:

1. Asset Financing

NBFIs provide financing for the purchase of physical assets such as automobiles, commercial vehicles, machinery, and other equipment. This service is crucial for businesses, especially SMEs, as it allows them to acquire the necessary assets for their operations without the need for significant upfront capital expenditure.

2. Consumer Credit

These institutions offer various types of consumer credit, including personal loans, education loans, and consumer durable loans. These loans help individuals meet their personal needs such as education expenses, medical emergencies, and purchasing consumer goods like electronics and appliances.

3. Housing Finance

NBFIs play a significant role in the housing sector by providing home loans to individuals and real estate developers. Housing Finance Companies (HFCs), a category of NBFIs, specialize in offering long-term financing solutions for the purchase or construction of residential properties.

4. Microfinance

Microfinance services target low-income individuals and groups who typically lack access to traditional banking services. Microfinance Institutions (MFIs) provide small loans, often without collateral, to support entrepreneurial activities and improve the livelihoods of the underserved sections of society.

5. Insurance Services

Many NBFIs also offer various insurance products, including life insurance, health insurance, and general insurance. These services provide financial protection against risks and uncertainties, helping individuals and businesses manage potential financial losses.

6. Investment and Wealth Management

NBFIs offer investment and wealth management services, including portfolio management, mutual fund distribution, and advisory services. These services help individuals and institutions manage their investments effectively, aiming for optimal returns while mitigating risks.

7. Leasing and Hire Purchase

Leasing services provided by NBFIs allow businesses and individuals to use assets without owning them outright. Under hire purchase agreements, customers can eventually own the asset after paying installments over a period. These services are particularly useful for acquiring expensive assets like machinery, vehicles, and equipment.

8. Factoring Services

Factoring involves the purchase of accounts receivable (invoices) from businesses at a discount, providing them with immediate cash flow. NBFC-Factors specialize in this service, helping businesses manage their working capital more effectively by converting their receivables into cash.

9. Infrastructure Finance

Infrastructure Finance Companies (IFCs) focus on providing long-term funding for large infrastructure projects such as roads, bridges, airports, and power plants. These projects are capital-intensive and require significant financing, which NBFIs are well-positioned to provide.

10. Venture Capital and Private Equity

Some NBFIs also engage in venture capital and private equity investments, providing funding to startups and growing companies in exchange for equity. This service supports the development of new businesses and innovation in the economy.

11. Commercial Finance

Commercial finance services include offering loans and advances to businesses for various purposes such as working capital, expansion, and capital expenditures. These loans are critical for business growth and operational efficiency.

12. Gold Loans

Many NBFIs offer loans against gold, where individuals can pledge their gold jewelry or bullion to secure short-term loans. This service is particularly popular in India, where gold is a common household asset.

13. Debt Restructuring and Corporate Advisory

NBFIs provide debt restructuring services to help companies in financial distress reorganize their liabilities and improve their financial health. They also offer corporate advisory services, including financial planning, restructuring, and mergers and acquisitions advisory.

14.7. GOVERNANCE AUTHORITY AND REGISTRATION REQUIREMENTS

The Reserve Bank of India (RBI) is the governing authority that issues licences to NBFCs, regulates their operations and ensures that they comply with laws and regulations while doing business. A company registered under the Companies Act, 1956, that wishes to commence its business as an NBFC specified under Section 45-I (A) of the Reserve Bank of India Act, 1934, should satisfy the following two conditions:

- Register under Section 3 of the Companies Act, 1956.
- Minimum Net Owned Fund (NOF) requirement of INR 200 lakhs. There is a separate NOF requirement for specialised NBFCs such as NBFC-MFIs and CICs.

14.8. GUIDELINES BY RBI FOR NON-BANKING FINANCIAL COMPANY IN INDIA

Creating the Reserve

It is mandatory for NBFCs to have a reserve of more than 5% but less than 25%. This is the percentage of deposits outstanding on the last working day when the business closes of the second preceding quarter. Also, it is specified by RBI, that the NBFCs have to invest a certain amount of reserves into approved securities. These securities should not have value at a price more than the current market price.

Registration Certificate

NBFCs do not require banking licenses but they do need to obtain a registration certificate from RBI so as to carry their business. To obtain the certificate, earlier the minimum net owned fun which is NOF was Rs. 25 lakh. But this was changed to a minimum of Rs. 2 crores from April 1999. This is done because of the strengthening of the financial sector and technology in this sector. The NOF of Rs. 2 crores to be achieved say for 2018 should be done in the following manner. Rs. 1 crore should be achieved by March 2017 while Rs. 2 crores to be achieved March 2018.

Creating the Reserve Fund

We discussed the need for reserves for NBFCs mandated by the RBI earlier. For this, NBFCs will also need to create the reserve fund. The NBFCs will have to create a reserve fund of an amount which is more than 20% of their net profit. This amount should be created before any dividend is declared.

14.9.REGULATION RELATED TO DEPOSIT ACCEPTANCE

Here are the regulations related to the acceptance of deposits by the NBFCs.

- Deposit periods
- Investments in liquid assets
- Ceiling on public deposits

Deposit Periods

- For NBFCs, the period of deposits is up to 60 months.
- PNBFCs are allowed to accept the deposits between 12 to 84 months.
- For MNBFCs, the deposits are to be done between 6 to 36 months.

Investments in Liquid Assets

NBFCs are allowed to invest in liquid assets up to 15% in public deposit liabilities. This can also be done at the last working day on the second preceding quarter. This 15% should include approved securities of more than 10% and deposits with scheduled commercial banks of less than 5%.

Ceiling on Public Deposits

For rated AFC that is asset finance companies, which are complying to all the prudential rules are allowed to accept deposits till four times of their NOF. But in 2014, to limit these deposits, the amount has been reduced to 1.5 times of NOF. For unrated AFC, an NOF of Rs. 25 lakhs and more is accepted when it complying with all the prudential rules and regulations.

Furthermore, the capital adequacy ratio should be more than 15%. Public deposits in such cases are allowed to be 1.5 times that of NOF or Rs. 10 crores.

14.10. PROBLEMS AND CHALLENGES ENCOUNTERED BY NBFCS

Non-Banking Financial Companies have been consolidating their presence in the financial market and have made noteworthy progress than regular banks. However, new or small NBFCs in India encountered some major challenges in protecting their presence against their popular counterparts.

- **Absence of Refinancing Option:** In India, regular banks are prepared with several refinancing options. Similarly, housing financing companies also have certain refinancing substitutions at their disposal, and it refinances from the regulator of Housing Financing Companies. On the other hand, the Non-Banking Financial Companies entirely depend on the capital market or banks to attain resources. This acts as a resistance to the NBFC growth. Moreover, always remember the flows of finds from these sources can get vanishes anytime.
- **Issues in availing NBFC License:** The process for obtaining an NBFC License is more difficult and complicated as compared to other licenses. The process involves complex and boring documentation processes and approval from the Reserve Bank of India (RBI). Always keep in mind that RBI controls the process, which should be followed by the applicant to avail NBFC Registration.
- **Complex NBFC Compliances:** Once the NBFC Registration is done, it also requires addressing some compliance. NBFC compliance differs from one type of company to another. So, the difficulty grassed on when a person running an organization of loans and advances, etc., it becomes difficult to know about the filing necessities of the suggested returns. This is probably one of the most complex challenges faced by NBFCs.
- **No Flexibility in Loan Classification of NPAs:** NPA or Non-Performing Assets bears important significance for the major players, but businesses with unpredictable cash flow encounter a negative impact on payment related delays. Classifications under NPAs and flexibility in scheduling are crucial. The arrangement of NPA ought to be based on assets financed rather than the profile of a borrower.
- **Absence of Legal Recovery Tool:** The insufficient statutory recovery tool is another complicated issue taunting the Non-Banking Financial Companies for a long.
- **Undue Tax Treatment:** There exists a great variation within the tax structure for banks vs NBFCs, such as **TDS (Tax Deducted at Source),** double taxation on the lease or hire purchase, etc.
- **Absence of Defaulter Database:** Non-Banking Financial Companies are more susceptible to credit risk under the influence of insufficient information. In addition to that, there is a necessity for essential statutory changes to control the payments database in the credit assessment's process.
- **Absent in Capacity Building**: NBFCs in India must create an accessible ecosystem for capacity building on a person as well as a collective basis. Then the bulk of the Non-Banking Financial Companies still lack the said perspective; hence, it must be addressed as quickly as possible.

14.11. REMEDIES TO THE CHALLENGES ENCOUNTERED BY NBFCS

Following are some remedies to overcome the challenges faces by NBFCs in India:

- **Team up with Fintech Companies**: The Non-Banking Financial Companies can team up with Fintech Companies since their services are affordable and innovative in terms of brokerage, payment, and credit scoring.

- **Assign SMEs to Manage Compliances:** An expert team of **Subject Matter Experts (SMEs)** can be appointed for NBFC License, compliances, and documentation. It will let them overcome differences through a general approach.

- **Create an Effective Business Plan and Observing Framework:** If a Non-Banking Financial Company is in its starting phase, it is crucial for them to summaries an understandable business plan along with an observing framework to keep their eyes on discrepancies.

- **Co-originating Lending:** It will let these financial companies overcome funding-related problems along with other disputes.

- **Implement Risk Management:** A company should set up a framework related to Risk Management since there are many difficulties that the company might face. It will strengthen the company to identify the possible loopholes with ease.

14.12. EMI (EQUATED MONTHLY INSTALLMENT)

Equated Monthly Installment (EMI) is a fixed payment amount made by a borrower to a lender at a specified date each calendar month. The concept of EMI is widely used in various types of loans, including home loans, car loans, personal loans, and other forms of credit. It allows borrowers to repay their loan over an extended period in manageable amounts, making it easier to plan their finances.

COMPONENTS OF EMI

An EMI comprises two main components:

Principal Amount: This is the original loan amount borrowed.
Interest: This is the cost of borrowing the principal amount, typically expressed as an annual interest rate.

The EMI is structured in such a way that it includes both the interest on the loan and a portion of the principal amount, ensuring that the loan is fully repaid over the loan tenure.

CALCULATION OF EMI

EMIs are calculated using a standard mathematical formula, which ensures that the monthly payment remains the same throughout the loan tenure, despite the changing interest and principal amounts. The formula for calculating EMI is:

$EMI=P\times r\times(1+r)n(1+r)n-1$EMI=(1+r)n−1P×r×(1+r)n

Where:
PP = Principal loan amount
rr = Monthly interest rate (annual interest rate divided by 12 and then by 100)

nn = Number of monthly installments or loan tenure in months

Example Calculation

Consider a loan amount (principal) of ₹1,00,000 at an annual interest rate of 12% for a tenure of 2 years (24 months). The monthly interest rate rr would be:
r=1212×100=0.01r=12×10012=0.01

Using the EMI formula:
EMI=1,00,000×0.01×(1+0.01)24(1+0.01)24−1EMI=(1+0.01)24−11,00,000×0.01×(1+0.01)24 EMI=1,00,000×0.01×1.268241.26824−1EMI=1.26824−11,00,000×0.01×1.26824 EMI=1,000×1.268240.26824EMI=0.268241,000×1.26824
EMI=1268.240.26824EMI=0.268241268.24 EMI≈₹4,717.47EMI≈₹4,717.47

So, the borrower would need to pay approximately ₹4,717.47 each month for 24 months to repay the loan.

AMORTIZATION SCHEDULE

The amortization schedule is a complete table of periodic loan payments, showing the amount of principal and the amount of interest that comprise each payment until the loan is paid off at the end of its term. Initially, a larger portion of the EMI is dedicated to interest payment, with a smaller portion going towards repaying the principal. Over time, the principal portion increases while the interest portion decreases.

BENEFITS OF EMI

Budgeting and Planning: EMIs provide predictability in financial planning, as borrowers know exactly how much they need to pay each month.

Affordability: Breaking down a large loan amount into smaller monthly payments makes borrowing more affordable.

Ease of Repayment: Fixed monthly payments simplify the repayment process, as borrowers don't need to worry about varying payment amounts.
Access to Larger Loans: EMIs enable borrowers to take out larger loans than they might be able to repay in a lump sum, facilitating significant purchases like homes and cars.

TYPES OF EMI LOANS

Fixed-Rate Loans: In these loans, the interest rate remains constant throughout the loan tenure, leading to a fixed EMI amount.

Floating-Rate Loans: The interest rate can vary over the loan tenure, leading to fluctuating EMI amounts. This is common in home loans.

PREPAYMENT AND ITS IMPACT ON EMI

Prepayment involves repaying a part of the loan before it is due. This can either reduce the EMI amount or shorten the loan tenure, depending on the borrower's preference.

Prepayment can save interest costs but might attract prepayment penalties depending on the lender's policies.

14.13. SUMMARY

In conclusion, NBFCs provide financial support for the expanding needs of both corporate and unorganised sectors, and they are rapidly expanding despite the global economy's slowdown. They have become more popular in recent years due to their flexible lending policies and focus on customer service. Given that NBFCs have become increasingly important to the growth of the economy and financial sector over the past few years, our Indian government has been concentrating on their development constantly. They receive a variety of forms of assistance in order to develop and broaden their presence in the expanding economy. These programmes include tax breaks, easier access to funding, and regulatory changes aimed at fostering an environment that is more favourable for NBFCs to operate in. Due to the fierce competition they face from banks, they must constantly find new sources of funding. Since they are unable to use low-cost deposits, they must obtain funding from debt and equity sources. To address these challenges, the RBI has implemented several measures to regulate NBFCs in India. These measures include stricter capital adequacy requirements, a more comprehensive regulatory framework, and increased disclosure requirements. The RBI has also introduced a mechanism for monitoring systemic risks associated with NBFCs.

The concept of EMI is a crucial aspect of the lending process, providing both borrowers and lenders a structured and predictable framework for loan repayment. By understanding how EMIs work, borrowers can make informed decisions about their finances, ensuring that they manage their debt effectively and plan their budgets efficiently.

14.14. KEY WORDS

Reserve Bank of India (RBI): The central bank of India responsible for regulating and supervising the country's financial system, including NBFIs.

Prudential Norms: Regulations set by the RBI aimed at ensuring the financial soundness and stability of NBFIs, including norms related to capital adequacy, asset classification, provisioning, and risk management.

Capital Adequacy Ratio (CAR): A measure of a NBFI's capital relative to its risk-weighted assets, used to assess its financial stability and ability to absorb losses.

Financial Stability Report (FSR): Periodic reports published by the RBI assessing the overall stability and risks within the Indian financial system, including the NBFI sector.

Shadow Banking: A system of non-bank financial intermediaries that provide services similar to traditional banks but operate outside of regulatory oversight, posing potential risks to financial stability.

Liquidity Risk: The risk that a NBFI may not be able to meet its short-term obligations due to a lack of liquid assets or an inability to access funding in the market.

Regulatory Reforms: Changes made to the regulatory framework governing NBFIs, aimed at addressing emerging challenges, enhancing financial stability, and promoting market efficiency and consumer protection.

14.15. SELF-ASSESSMENT QUESTIONS

Essay type questions

1. Define NBFC and write the functions of NBFCS?
2. Describe different types of NBFCS?
3. What are the problems and challenges encountered by NBFCS and remedies to the challenges? Discuss.

Short type questions

1. How NBFCS are different from banks?
2. What are the guidelines by RBI for non-banking financial company in India?
3. What are the components of EMI?

14.16. SUGGESTED READINGS

1. R. K. Uppal: Regulation of Non-Banking Financial Companies: Law, Rules, and Regulations, Bharat Law House Pvt. Ltd. New Delhi, 2019.
2. Pranav Kothari: Non-Banking Financial Companies in India: Issues and Challenges, Springer Publications, Singapore, 2018.
3. Dr. Aman Agarwal: Legal Aspects of NBFCs Regulation in India, Corporate Professionals Capital Pvt. Ltd. New Delhi, 2017.
4. Vivek Rathi: Non-Banking Financial Companies: Problems and Solutions, Taxmann Publications Pvt. Ltd. New Delhi, 2016.
5. C. S. V. Murthy: Regulation of Non-Banking Finance Companies, Lexis Nexis Publications, Gurgaon, 2015.

Dr. P. Mercy Kumari

LESSON – 15

FINANCE SERVICE COMPANY LOANS AND ITS CUSTOMERS

Aims and Objectives:

After reading this lesson the student would know the following aims and objectives of:

- To understand the importance of finance service company
- To study the types of loans by finance service company
- To know the needs of customer
- To understand the types of customers

Structure

15.1 Introduction
15.2 Understanding the Indian financial system
15.3 Types of financial services in India
15.4 Top financial services companies
15.5 What is a loan?
15.6 The loan process
15.7 Components of a loan
15.8 Types of loans available in India
15.9 Finance service company customers
15.10 Customer needs
15.11 Summary
15.12 Key words
15.13 Self-assessment questions
15.14 Suggested readings

15.1. INTRODUCTION

The term "financial services" is an umbrella concept for a range of financial services provided by the industry. Owing to its sheer massiveness in the number of services provided and the demand drivers, the financial services sector in India is witnessing an upward trajectory. With numerous job opportunities available, a simple financial analysis course can put you on the track to success in the field of finance as a financial analyst. All services related to money are considered financial services. Banking, mortgages, credit cards, payment services, tax preparation and planning, accounting, and investing are types of financial services industries. Financial services are frequently the exclusive domain of businesses and professionals.

Efficient operation of the economy depends on the financial services. Financial services enable people to make big purchases and save for the future. It allows for the free flow of capital and market liquidity. The economy expands, and businesses in this area are better able to manage risk when the sector is robust. It also allows a proper framework to function during financial planning. It’s a high-growth sector with ample job opportunities.

The current financial regulatory___framework is often criticised due to its incompleteness, demanding it to be reformed.

15.2. UNDERSTANDING THE INDIAN FINANCIAL SYSTEM

The Indian financial system is primarily divided into two segments: banks and non-banking financial institutions. These two segments also come with subcategories. Under banks are the commercial and cooperative ones. The commercial banks are divided into schedule and non-schedule banks. The schedule banks consist of public sector banks, private sector banks, foreign banks, regional rural banks, small financial banks, and payment banks. Whereas local area banks are classified as non-scheduled banks.

The non-banking financial institutions, or NBI, consist of All India Financial Institutions (AIFI), NBFCs, Primary Dealers, Credit Information Companies. All India Financial Institution consist of bodies such as NABARD, EXIM, NHB, SIDBI, and MUDRA.

15.3. TYPES OF FINANCIAL SERVICES IN INDIA

The Indian financial services industry consists of many segments and crucial sub-segments. Here are some of the major types of financial services in India:

- **Banking**
  The financial services sector in India is anchored by the banking sector. Numerous banks from the public, private, foreign, regional rural, and urban/rural cooperative sectors exist throughout the nation. Individual banking, business banking, and loans are some of the financial services provided under this segment. The Reserve Bank of India (RBI) oversees and maintains the liquidity, capitalization, and financial stability of the banking system.
- **Professional Advisory**
  In India, there is a strong presence of professional financial advising service providers who offer a variety of services to both people and businesses, including investment due diligence, M&A counselling, valuation, real estate consulting, risk consulting, and tax consulting. Numerous service providers, from small domestic consulting firms to huge multinational corporations, provide these services. This is one of the more common types of areas in financial services.
- **Wealth Management**
  According to the clients' financial objectives, risk tolerance, and time horizons, financial services offered within this segment include managing and investing customers' wealth across a variety of financial instruments, encompassing real estate, commodities, loans, stock, mutual funds, insurance, derivatives, and structured goods. Any finance enthusiast must also familiarise them self with the advantages of financial risk management.
- **Mutual Funds**
  Providers of mutual funds offer expert investment services for funds made up of several asset classes, usually debt and equity-linked assets. Due to their typically lower risks, tax advantages, predictable returns, and qualities of diversification, these products are particularly popular in India. Due to its popularity as a low-risk wealth multiplier, the mutual fund market has seen double-digit growth in assets under management over the last five years.

- **Insurance**

  This type of financial service falls under personal finance. General insurance and Life insurance are the two main categories of financial services offered in this market area. Solutions for insurance give people and businesses protection from accidents and unanticipated events. Pay-outs for these products depend on a number of important qualitative and quantitative factors, including the product's type, time horizons, customer risk assessment, premiums, and others. The Insurance Regulatory and Development Authority of India (IRDAI) oversees the insurance industry.
- **Stock Market**

  The stock market segment offers a variety of equity-linked investment solutions for users of the National Stock Exchange and Bombay Stock Exchange in India. Customers' returns are based on capital appreciation, which is growth in the equity solution's value and/or dividends, as well as payments made by businesses to their investors.
- **Treasury/Debt Instruments**

  Investments in bonds issued by governments and commercial organisations are among the services provided in this category (debt). At the conclusion of the investment period, the bond issuer (borrower) gives the investor fixed payments (interest) and principal repayment. Listed bonds, non-convertible debentures, capital-gain bonds, GoI savings bonds, tax-free bonds, etc. are some examples of the different types of instruments in this area.
- **Tax/Audit Consulting**

  This market encompasses a broad range of financial services in the areas of tax and auditing. Based on the clientele they serve, businesses and individuals, this service domain can be divided into: individual tax (calculating tax obligations, submitting tax returns, receiving tax-savings advice, etc.); Business tax (Determining tax liabilities, structuring and analysing transfer prices, registering for GST, providing tax compliance advice, etc.). Services in the auditing sector include statutory audits, internal audits, service tax audits, tax audits, process and transaction audits, risk audits, stock audits, etc.
- **Capital Restructuring**

  These services, which are largely provided to businesses, include changing capital structures (debt and equity) in order to increase profitability or address emergencies like bankruptcies, volatile markets, liquidity shortages, or hostile takeovers. In this market, complex deals, lender negotiations, rapid M&A, and capital raising are typical examples of financial solutions. The types of financial solutions in this segment typically include structured transactions, lender negotiations, accelerated M&A and capital raising.
- **Portfolio Management**

  Through portfolio managers who assess and optimise investments for customers across a wide range of assets, this segment offers a highly specialised and tailored variety of solutions that help clients achieve their financial goals. These services are non-discretionary and broadly targeted at HNIs.

15.4. TOP FINANCIAL SERVICES COMPANIES

- Mahindra and Mahindra Financial Services Ltd.
- HDB Finance Services
- Bajaj Finance Ltd.

- IDFC First Bank Ltd.
- Muthoot Finance Ltd.
- Tata Capital Financial Services Ltd.
- Aditya Birla Finance Ltd.
- Cholamandalam Investment & Finance Company Limited
- L&T Finance Holdings Ltd.

15.5. WHAT IS A LOAN?

A loan is a sum of money that one or more individuals or companies borrow from banks or other financial institutions so as to financially manage planned or unplanned events. In doing so, the borrower incurs a debt, which he has to pay back with interest and within a given period of time. The recipient and the lender must agree on the terms of the loan before any money changes hands. In some cases, the lender requires the borrower to offer an asset up for collateral, which will be outlined in the loan document. A common loan for American households is a mortgage, which is taken for the purchase of a property.

Loans can be given to individuals, corporations, and governments. The main idea behind taking out one is to get funds to grow one's overall money supply. The interest and fees serve as sources of revenue for the lender.

Understanding loans

A loan is a form of debt incurred by an individual or other entity. The lender—usually a corporation, financial institution, or government—advances a sum of money to the borrower. In return, the borrower agrees to a certain set of terms including any finance charges, interest, repayment date, and other conditions. In some cases, the lender may require collateral to secure the loan and ensure repayment. Loans may also take the form of bonds and certificates of deposit (CDs). It is also possible to take a loan from a 401(k) account.

15.6. THE LOAN PROCESS

Here's how the loan process works: When someone needs money, they apply for a loan from a bank, corporation, government, or other entity. The borrower may be required to provide specific details such as the reason for the loan, their financial history, Social Security number (SSN), and other information. The lender reviews this information as well as a person's debt-to-income (DTI) ratio to determine if the loan can be paid back. Based on the applicant's creditworthiness, the lender either denies or approves the application. The lender must provide a reason should the loan application be denied. If the application is approved, both parties sign a contract that outlines the details of the agreement. The lender advances the proceeds of the loan, after which the borrower must repay the amount including any additional charges, such as interest.

The terms of a loan are agreed to by each party before any money or property changes hands or are disbursed. If the lender requires collateral, the lender outlines this in the loan documents. Most loans also have provisions regarding the maximum amount of interest, in addition to other covenants, such as the length of time before repayment is required.

Why are loans used?

Loans are advanced for a number of reasons, including major purchases, investing, renovations, debt consolidation, and business ventures. Loans also help existing companies expand their operations. Loans allow for growth in the overall money supply in an economy and open up competition by lending to new businesses. The interest and fees from loans are a primary source of revenue for many banks as well as some retailers through the use of credit facilities and credit cards.

15.7. COMPONENTS OF A LOAN

There are several important terms that determine the size of a loan and how quickly the borrower can pay it back:

- **Principal:** This is the original amount of money that is being borrowed.
- **Loan Term:** The amount of time that the borrower has to repay the loan.
- **Interest Rate:** The rate at which the amount of money owed increases, usually expressed in terms of an annual percentage rate (APR).
- **Loan Payments:** The amount of money that must be paid every month or week in order to satisfy the terms of the loan. Based on the principal, loan term, and interest rate, this can be determined from an amortization table.

In addition, the lender may also tack on additional fees, such as an origination fee, servicing fee, or late payment fees. For larger loans, they may also require collateral, such as real estate or a vehicle. If the borrower defaults on the loan, these assets may be seized to pay off the remaining debt.

15.8. TYPES OF LOANS AVAILABLE IN INDIA

Loans can be broadly categorised into secured and unsecured loans based on whether they require collateral or not. Secured loans require collateral whereas unsecured loans do not. Each of these two categories has a list of loan products listed with each product serving a specific purpose. It's better to understand the features of different types of loans available in India so you can make an informed decision while applying for a financing facility. Based on the security provided, loans can be classified into two main categories:

1. SECURED LOANS 2. UNSECURED LOANS

15.8.1. SECURED LOANS

Secured loan refers to loans where you have to pledge collateral. A prime example of secured loans would be home loans. In the case of a home loan, your house acts as a security to the lender. In case you default on your loan, the lender holds the right to seize your property to recover the loan dues. Generally, secured loans have lower interest rates than unsecured loans because of the collateral involved.

DIFFERENT TYPES OF SECURED LOANS IN INDIA

A secured loan refers to a loan under which an individual pawns an asset to borrow money. The loan amount for this depends on the collateral's value. In case of a default, the lending party can repossess, foreclose, size or liquidate this asset to compensate for the borrowed sum. These loans often come with few qualification requirements due to their safe

nature. As such, borrowers can get much-need cash to make high-value purchases. The following loans come under the category of secured loans:

1. Home Loan

Home loans are secured loans that are utilised to purchase land or property. There are different types of home loans available in India, namely land purchase loans, home construction loans, home improvement loans, etc.

2. Gold Loan

Gold loans are loans secured against gold ornaments or coins or bullion. The borrower pledges gold ornaments to the lender in exchange for funds as per the applicable loan-to-value norms. Gold loan interest rates could be lower than personal loans.

3. Loan against Property

A loan against property or LAP is a secured loan sanctioned against a property pledged as collateral. The LAP amount doesn't have any end-use restrictions, meaning, you can use the amount for any financial requirement.

4. Loan Against Insurance Policies

Certain types of life insurance policies like endowment plans and traditional policies could qualify as security for a loan against an insurance policy. The maximum loan amount could be up to 90% of the policy's surrender value (not its sum assured), and banks could charge an interest rate based on their 1-year MCLR rate.

5. Loan Against Mutual Funds and Shares

Mutual funds and shares can also be pledged as collateral in exchange for funds. Lenders could sanction up to 65% of the NAV of eligible shares and equity funds, and up to 85% of eligible debt funds as a loan. The loan funds could be used for any purpose; however, the pledged shares or fund units cannot be redeemed unless the loan is cleared in full. That said, the unpledged fund units and shares would continue earning interest as per performance.

6. Loan Against PF/EPF

If you have a Provident Fund (PF) account, it is possible to get a loan against your PF account. Such loans are considered as a premature withdrawals and no additional interest rate would be charged. However, premature PF withdrawal is only allowed for certain predefined requirements like medical emergency, home purchase, wedding, unemployment, etc. subject to terms and conditions.

7. Loan Against Fixed Deposit

A loan against FD is a type of loan where you can secure funds using your fixed deposit as collateral. You can borrow a certain percentage of the total deposit amount, typically up to 90-95% of the deposit, depending on your bank's policies. The interest rate on such a loan is usually up to 2% higher than the applicable FD rate.

8. Vehicle Loan

Vehicle loans are usually secured loans that help you finance your dream vehicle like a car, bike or electric vehicle. The concerned vehicle works as collateral against your loan.

9. Car Loan

If you're planning to purchase a car, you can opt for car loans. Lenders could offer up to 85% of the car's ex-showroom price as a loan as per their terms and conditions. That said, car loans could further be classified as new car loans and used car loans.

10. Two-wheeler Loan

You can opt for two-wheeler loans to purchase a motorcycle or a scooter of your choice. You can get up to 85% financing of the on-road value of the two-wheeler as a loan, wherein the vehicle would be pledged as collateral.

FEATURES OF A SECURED LOAN

Some of the crucial features of secured term loans are as follows:

- Flexible loan repayment offers compared to regular loans
- Lower lending risks and rates of interest
- Swift approval of a loan
- Consumers can customise loans based on their requirements.
- Applicants can choose between variable and fixed rates.
- Self-employed people, and corporate and proprietorship businesses can also avail of such loans.
- When a borrower defaults, financial entities can repossess his/her assets.
- Enhances a customer's CIBIL score after repayment of the loan amount.
- These loans do not require guarantors.

CONDITIONS FOR A SECURED LOAN

The eligibility criteria to opt for secured loans are as follows:

- You should be an Indian resident
- You must be 18 years or above
- Earnings include business income, non-salaried and salaried income
- Financial institutions often require a yearly income of Rs. 3,00,000 (minimum).
- An applicant, having a business, needs to prove that he/she has been operating and gaining from that business for the previous three years.
- A customer must possess an asset, the value of which must be greater than or equal to the loan amount.

15.8.2. UNSECURED LOANS

An unsecured loan is a loan where you don't have to pledge collateral. Your loan eligibility and interest rate is decided based on your creditworthiness – your income, repayment capacity and credit score. A cash loan or personal loan would be the best example for unsecured loans. Interest rates for unsecured loans could be slightly higher than secured loans because of the higher risks involved due to the absence of collateral.

An unsecured loan is a type of loan that doesn't require any collateral. In other words, you don't have to pledge an asset, such as a house or car, to get the loan. Instead, the lender will assess your loan eligibility based on your credit score, repayment history, and income levels.

How Does an Unsecured Loan Work?

The lender of an unsecured loan will not require any collateral from you. To evaluate your creditworthiness, a lender could use parameters, such as your current credit score, your default history, your current income levels, and your debt-to-income ratio. Based on this assessment, a lender will decide whether to approve or reject your application. Also, based on your credit profile, the lender will decide the interest rate for your loan.

Upon approval, the cash will be disbursed to you. It could either be transferred directly to your bank account or the lender might issue a cheque or a demand draft. You are expected to make periodic repayments – the frequency at which you need to repay will be mentioned in your loan agreement and schedule. The payments you make will consist of two components – the principal and the interest. The principal is the amount you borrowed and the interest is the fee the lender is charging on the loan. If you default on the payment of an unsecured loan, your credit score will take a hit. Moreover, a lender may impose late payment charges and higher interest rates on the outstanding payment.

DIFFERENT TYPES OF UNSECURED LOANS IN INDIA

1. Personal Loans

Personal loans are unsecured loans that can be used to meet any type of financial requirement – from emergencies and home renovation to fund a vacation or wedding. Pre-approved customers and applicants with stable income and high credit score can get personal loans at the lowest applicable rates.

2. Cash Loan

A cash loan is similar to a personal loan; however, eligible applicants can get such a loan in a few minutes through the lender's mobile application in a 100% paperless process. They too, like personal loans, can be used for any requirement with no end-usage restrictions whatsoever.

3. Education Loans

Education loans are used to fund higher education in India or abroad. They cover not just the tuition fees of the educational institutions but also the accommodation and other living expenses borne by the students during the course of study. But while education loans are typically unsecured in nature, lenders could ask for collateral or guarantor to approve certain education loan applications involving high loan quantum.

4. Agricultural Loans

Agricultural loans are available for different kinds of farming-related activities. Financial institutions offer monetary aid to farmers all across the country.

5. Flexi Loans

A flexi loan is a financing facility wherein the borrower avails of a certain amount and pays interest only for the amount used.

6. Credit Card Loans

Loans on credit card are linked to a user's credit card account that may or may not be linked to the card's credit limit. The loan repayment EMIs are typically clubbed with the card's monthly bill. While these loans could be availed of quickly involving zero paperwork and used for any financial requirement, their interest rates are typically much higher than personal loan rates. Thus, they should be used only as a last option and for as low an amount as possible.

7. Short-term Business Loans

Short-term business loans are unsecured loans that are useful for meeting the daily expenses or diversification of a business, organisation or entity.

8. Payday Loan

A payday loan is a short-time loan typically with a smaller ticket-size, wherein the lender gives the loan at a higher rate of interest. The tenure of payday loans is generally shorter than personal loans.

9. Overdraft

A bank overdraft allows eligible customers to withdraw money or make eligible transactions up to a predefined limit even if their account balance is zero. The interest is

charged only on the utlised overdraft amount and not the entire overdraft limit. However, certain types like overdraft against FD and insurance policies are considered secured loan options.

FEATURE AND BENEFITS OF UNSECURED LOAN

- No collateral or guarantor required
- Flexible tenure and EMI options
- Quick processing and disbursal
- Can be used for any legitimate purpose
- Less stringent eligibility criteria than secured loans

Unsecured Loan Interest Rate and Charges

The interest rate on unsecured loans starts from 9.9% p.a and goes up to 45% p.a., which depends upon your credit score and credit history. Here are some of the other fees and charges:

- **Processing fee:** Typically 0.5% to 2.5%
- **Foreclosure fee:** Normally between 2% to 5% of the outstanding amount
- **Late payment charges:** Between 2-3% per month
- **Verification fee**: It could vary from lender to lender

ELIGIBILITY CRITERIA FOR UNSECURED LOAN

- **Minimum age:** 18 years
- **Maximum age:** 65 years
- **Nationality:** Indian resident
- **Type of employment:** Salaried or self-employed or someone with a regular, stable source of income
- **Minimum credit score:** 650 and above (could be higher, depending on the lender)
- **Debt-to-income ratio:** Generally, a good debt-to-income ratio, not exceeding 36%

15.9. FINANCE SERVICE COMPANY CUSTOMERS

Customers play a significant role in any business. To understand customer behavior and better allocate resources to different customers to generate the highest profit, it is necessary to identify and segment different types of customers. By better understanding the different types of customers, businesses can be better equipped to develop successful strategies.

TYPES OF FINANCE SERVICE COMPANY CUSTOMERS

In finance service companies customers can be segmented into five main types:

1. Loyal Customers

Loyal customers are the most important segment to appease and should be top-of-mind for any company. This type of customers generally represents no more than 20% of a company's customer base but contributes the majority of sales revenue. Loyal customers, as the name implies, are loyal and value a product heavily. In addition, loyal customers are

likely to recommend the company's products to other people. Therefore, it is important to solicit their input and feedback and involve them in a company's decision-making process. Heavy emphasis should be placed on loyal customers if a company wants to grow.

2. Impulse Customers

Impulse customers are the best customers to upsell to and are the second most attractive segment (after loyal customers) to focus on. Impulse customers do not have a specific shopping list in mind and purchase products spontaneously. In addition, impulse customers are typically receptive to recommendations on products. Impulse customers are second to loyal customers in the generation of sales revenue. Keeping these customers in the loop on new product offerings goes a long way in improving a company's profitability.

3. Discount Customers

Discount customers play an important role in turning over a company's inventory. Therefore, discount customers are a key contributor to a company's cash flow. This type of customer seldom purchases products at full price and shops around for the best markdowns. Discount customers are resilient to upselling, are usually the least loyal segment of customers, and generally move on when better markdowns are available elsewhere.

4. Need-Based Customers

Need-based customers are driven by a specific need. In other words, they enter the store quickly, purchase what they need, and leave. These customers buy for a specific need or occasion and are hard to upsell. It is important to note that need-based customers can be easily drawn to other businesses. Therefore, it is important to initiate positive personal interaction with this customer segment in order to retain them. Converting need-based customers to loyal customers is attainable with proper positive personal interactions.

5. Wandering Customers

Wandering customers draw the largest amount of traffic to the company while making up the smallest percentage of sales revenue. They have no specific need or desire in mind and are attracted by the location of the business more than anything else. These customers enjoy the social interaction of the shopping experience. Therefore, spending too much time trying to appease this segment can draw away from the more profitable segments. Although this segment generates the least amount of sales revenue, providing insightful information about products to these customers can stimulate interest and ultimately result in a purchase.

15.10. CUSTOMER NEEDS

Customer needs are the motivations that make someone want to purchase a product or service and stay loyal to that business. People don't generally open their wallets to spend money without getting something in return. Even when making a donation, there's an incentive like feeling good or connecting to a cause. To be successful, businesses need to tap into unmet customer needs and offer solutions.

Customer needs are the psychological and physical motivations that make someone want to purchase a product or service and stay loyal to that business. For example, customers today need quick and convenient ways to reach support online. If a business doesn't provide an online experience that's on par with, or better than, an in-person experience, customers might leave for a competitor that does.

TYPES OF CUSTOMER NEEDS

Most customers have a set of 7 basic needs when they interact with an organization. They are described as follows:

1. Friendliness

This is the most basic customer need that's associated with things like courtesy and politeness. Friendly agents are a top indicator of a good customer experience, according to the customers surveyed in our 2021 Trends Report.

2. Empathy

Customers need to know the organisation understands and appreciates their needs and circumstances. In fact, 49% surveyed in our 2021 Trends Report said they want agents to be empathetic.

3. Fairness

Customers must feel that they're getting adequate attention and fair and reasonable answers.

4. Control

Customers want to feel like they have an influence on the outcome. You can empower your customers by listening to their feedback and using it to improve.

5. Alternatives

Customers want choice and flexibility from customer service; they want to know there is a range of options available to satisfy them. In fact, high-performing companies are more likely to provide customers with a choice of customer service channels. 50% of high performers have adopted an omnichannel support strategy, compared to 18% of their lower-performing peers.

6. Information

Customers want to know about products and services in a pertinent and time-sensitive manner; too much information and selling can be off-putting for them. A knowledge base is a great way to provide existing customers with the information they need, when they need it. And high-performing CX teams are more likely to offer a knowledge base, according to our research.

7. Time

Customers' time is valuable and organisations need to treat it as such. 73% of customers said resolving their issues quickly are the top component of a good customer experience. To deliver on that expectation, CX teams need customer service software that arms them with tools to respond to customers quickly and effectively.

HOW TO IDENTIFY CUSTOMER NEEDS

To identify the needs of your customers, there are 5 methods for identifying customer needs:

1. Focus groups

A focus group is a group of deliberately chosen people who participate in a discussion on a specific topic. These groups are run by market research and are facilitated by a moderator to encourage everyone's active participation. Focus groups are great for getting a sense for consumers' feelings and perceptions about your brand. They can also help you gather psychographic data — information about a person's values, interests, and attitudes, and what triggers them to act.

2. Customer surveys

Surveys are a traditional way to gather information from larger groups of people. Most surveys are in Q&A format to provide metrics. Millions of surveys are sent out each year, and are now mostly done online. If you want to understand what current customers (or potential customers) think of your product or brand, a survey can help you glean these insights. But surveys are only as good as their design — it's crucial to be clear on what you

want to know, how you word questions, who your demographic is, and how the survey is structured.

3. Social media listening

More and more businesses are seeing the importance of being present on social media for customer service. Data shows that your customers want to communicate with you in the same way they do with friends and family — and that often means social channels. Connecting with customers on their preferred channel also helps to create a more meaningful relationship. And, it's an excellent way to hear real-time feedback from your customers about what they like (and what they don't). If you start to see the same questions or issues pop up over time, it's a good clue that you have a customer need to solve for.

4. Keyword research

The last time you were wondering where to find the best pair of hiking boots, what did you do? Most likely, you searched online for advice. That's what makes keyword research so important – it helps a business identify popular search terms and phrases people key into search engines. See where your company is ranking compared to competitors by doing an "incognito" search for your industry or product. If you aren't on the first page, you aren't as likely to be found by your customers. This is a crucial insight for small businesses and enterprises alike.

People look for different information depending on where they are in the customer journey. For example, "hiking boots" will turn up a much different search engine results page (SERP) than "hiking boots for women size 8." The first is a top-of-funnel informational search, whereas looking for a specific size indicates a greater intent to purchase. By investing some time in keyword research, you can optimize your website to rank higher in search results, and gain insights about what your customers are searching for.

5. Customer journey mapping

To meet your customer's needs, you need to understand what they're looking for and what phase of the customer journey they're in, from discovery to purchase. Customer journey mapping is the process of creating a visual representation of your customers' interactions with your brand. It helps you see things from your customers' perspective, and gain insights about potential roadblocks and how to improve the experience.

"The experience matters at every moment in the customer journey, and customers will judge any impediment along the way," said Harry Wray, Customer Success Executive at Zendesk. "It's crucial to consider the experience from the customer's perspective to understand their needs."

Data shows that paying attention to the customer experience is critical. According to the Zendesk Customer Experience Trends Report, roughly half of customers say they would switch to a competitor after just one bad experience. That number increases to 80% after more than one bad experience. To keep your customers happy and create loyalty, you need to optimize your CX. Customer journey mapping is a tool you can use to find ways to create those good experiences.

HOW TO MEET CUSTOMER NEEDS

1. Provide excellent customer service

Countless studies have identified customer service as a competitive differentiator, even over price, and a key component of customer loyalty. In fact, 75 percent of customers are willing to spend more to buy from companies that give them a good service customer experience. Delivering fast, efficient, and seamless customer support is one of the first steps to meeting customers' needs.

2. Build customer empathy into everything you do

Nearly 50 percent of customers want agents to be empathetic, and 54 percent want to buy from companies that prioritize diversity, equity, and inclusion in their communities and workplaces. What's more, 63 percent want to buy from companies that are socially responsible. Customer empathy means seeing things from the customer's perspective. As a business, it is the ability to understand what a customer experiences when they use your company's products or services.

3. Use artificial intelligence to predict customer needs

You don't need a crystal ball to predict your customer needs – but you do need data. The good news is, your customers are creating and sharing more data with you than ever before. 2.5 quintillion bytes of data are created every day. To put that number in perspective, it would take about 210,000 years for a quintillion gallons of water to go over Niagara Falls. It's a colossal amount of information. But most companies aren't using their customer data to make business decisions.

Predictive analytics and artificial intelligence (AI) use science to predict what might happen in the future — from what your customers need to the big trends. Netflix, for example, tailors watch lists for each subscriber based on their data profile — demographics, ratings, watch history and preferences influence what the algorithm will recommend. And, the focus on machine learning has proven to deliver results: about 80% of what's watched on Netflix is based on these AI-powered recommendations.

4. Know your customers

This one might sound obvious, but how well do you actually know your customers? To make demand forecasting effective, you need to collect and integrate data about your customers, your offerings, and the triggers to purchase. Then you can create a buyer persona for each of your customer segments and plan marketing and product strategies for each.

This starts with the basics: demographic customer data like age, location, psychographic lifestyle and income. Previous purchases are often a good clue to what a customer will buy next. That data is usually easier to collect in online channels like in-app purchases or social media click-through. It can be a bigger challenge to collect this data from offline channels — and this is where loyalty programs can be extremely helpful for tracking buying behavior.

On top of fostering a better customer relationship, loyalty programs can help businesses get to know their customers better. That, in turn, helps them create a better customer experience and the circle continues.

5. Know the buying patterns of your target customers

It's critical to understand context when you're trying to predict customer needs. How do your customers prefer to contact you? If you aren't present on their channel of choice (email, phone, social media, app) you are missing out on an opportunity. Other factors can affect customer demand — including the season, state of the economy, and even time of day. If your product is a quick impulse item like a candy bar, you'll plan for it differently than a long-lead luxury piece like a diamond ring. Understanding customer behavior and planning to meet their demands.

Companies that collect and analyze data about their customers, their purchase patterns, and the context can create much more targeted offers. For example, some companies can predict whether you're likely to get married soon based on purchase patterns and tailor their marketing offers to that context. It's also possible to predict whether a customer is more likely to respond to an offer via mobile through data analytics.

15.11.SUMMARY

Financial services in India serve a variety of purposes supplied by the financial sector. The term financial services in India are commonly used to describe firms that manage the money supply. Institutions, financial firms, insurance companies, payment processors, and brokerage firms are all examples. The Internet and globalization are the destiny of financial organizations delivering financial services in India. Businesses that can build internationally effective platforms that handle consumers well, incorporate other parties through partnerships or networks, and also engage with customers, will have a promising future. Financial institutions must respond to consumer requirements more swiftly, most often beyond their established regional competence. Customer needs are the psychological and physical motivations that make someone want to purchase a product or service and stay loyal to that business. For example, customers today need quick and convenient ways to reach support online. If a business doesn't provide an online experience that's on par with, or better than, an in-person experience, customers might leave for a competitor that does.

15.12.KEY WORDS

Secured Loans: Loans backed by collateral, such as home equity loans or auto title loans.

Unsecured Loans: Loans without collateral, like personal loans or credit card loans.

Credit Unions: Member-owned cooperatives providing financial services, often with lower interest rates and fees.

Online Lenders: Non-bank financial institutions offering loans through online platforms.

Finance Service Company (FSC): A financial institution that provides a range of financial services, including loans, to individuals and businesses. Ex: Banks, credit unions, online lenders, peer-to-peer lending platforms, microfinance institutions.

Personal Loans: Unsecured loans used for personal expenses like medical bills, vacations, or home improvements.

Debt Consolidation Loans: Combining multiple debts into a single loan with lower interest rates, simplifying debt management.

Secured Loans: Loans backed by collateral, such as home equity loans or auto title loans, reducing the lender's risk.

Unsecured Loans:

Loans without collateral, like personal loans or credit card loans, relying solely on the borrower's credit worthiness.

Emergency Funding: Loans to cover unexpected expenses like medical emergencies or car repairs.

15.13.SELF-ASSESSMENT QUESTIONS

Essay type questions

1. Why financial services are important and explain the types of financial services in India?
2. Describe the process of loan and write the types of loans available in India?
3. Write the importance of Customer needs and explain the types of customer needs?

Short type questions

1. Write the Components of a loan?
2. Write the types of financial services in India?
3. How to meet customer needs?

15.14.SUGGESTED READINGS

1. Sanjay Rode: Types of Loans and Advances in India: Understanding the Basics, Notion Press Publications, Chennai, 2020.
2. Dr. P. K. Gupta: Understanding the Customer Behavior in Financial Services, PHI Learning Pvt. Ltd. New Delhi, 2019.
3. Dr. S. S. Hundal: Types and Needs of Financial Services, Khanna Publishers, New Delhi, 2018.
4. V. K. Bhalla: Financial Services for All, S. Chand & Company Ltd., New Delhi, 2017.
5. N. S. Rajan: Customer Relationship Management in Financial Services, McGraw-Hill Education, New York, 2016.

Dr. P. Mercy Kumari

LESSON – 16

MARKETING OF FINANCE SERVICE COMPANY LOANS

Aims and Objectives:

After reading this lesson the student would know the following aims and objectives of:

- To understand strategies for financial service marketing
- To understand loan procedure
- To understand debt collection process

Structure

16.1 Introduction
16.2 Strategies for financial service marketing
16.3 Loan procedure
16.4 Collection and recovery of FSC loan
16.5 Debt recovery terminology
16.6 The debt collection process
16.7 Phases to the debt collection process
16.8 Initial contact from debt collectors
16.9 Debt collection laws
16.10 Legal action vs. debt collectors
16.11 Debt recovery process
16.12 Summary
16.13 Key words
16.14 Self-assessment questions
16.15 Suggested readings

16.1 INTRODUCTION

Financial service marketing is the process of promoting the products and services of a financial services firm. Marketing efforts for any company typically have the goals of raising brand awareness, attracting customers, making sales and generating revenue. Here are some examples of financial services firms that may benefit from marketing:

- Commercial banks
- Credit unions
- Financial planning firms
- Accounting firms
- Investment banks
- Insurance companies
- Brokerage firms
- Mutual funds institutions
- These organizations may aim to help customers by providing support services, such as:
- Banking

- Loans
- Wealth management
- Insurance
- Financial advice
- Stocks and investments
- Accounting and bookkeeping
- Tax consulting

Financial services are useful to a variety of institutions. This is because many organizations and agencies, whether for-profit, nonprofit or government, require funds and resources to operate. Financial service businesses have teams of experts in complex financial and economic matters and can help companies or individual clients with managing money and capital responsibly. Marketers for finance businesses can create content for specific target audiences to capture attention and attract clients. Here are some common clients of financial service firms:

Individual customers:

Many people use financial service firms like banks daily to save and transfer money, take out and pay back home and auto loans and make investments.

Commercial businesses:

These clients may pay financial services companies to manage their books and ensure adherence to tax and other business-related financial laws and regulations.

Health care facilities:

Health care facilities often work with insurance companies and other financial institutions to process insurance claims and transfer payments for services rendered.

Educational institutions:

Schools, colleges and universities may require the services of accounting firms and other finance businesses to keep track of school expenses and support the finances of staff and students.

16.2. STRATEGIES FOR FINANCIAL SERVICE MARKETING

Financial service marketing is different from other forms of advertising. To develop the best strategies for these services, consider the organization's mission and goals, target markets and available resources. Here are 10 strategies for conducting effective financial service marketing campaigns:

1. DIGITIZATION

Providing digital products can help you market your financial services and gain more customers. For example, you might develop a mobile app for customers to sign in to online accounts, view their finances, gain customer support, schedule services or make purchases from their phones or tablets. Along with increasing convenience for both customers and employees, digitization can help to keep sensitive financial information safe.

2. USER EXPERIENCE

Optimizing user experience means making it easy for users to navigate a business's digital resources. Ensuring a company's website, app and other resources are free of errors is critical to maintaining customers. By offering a high-quality user experience, you can convince customers of the superior quality of your financial products and services.

3. SOCIAL MEDIA MARKETING

Many modern consumers use social media daily. Advertising your finance business services on various social media platforms can reach a large variety of audiences and encourage people to visit your website, explore more about the business and even make purchases. Make sure to include easy links to email lists, apps and other financial resources so customers can navigate from social media apps to the business.

4. EDUCATION

Providing educational materials to customers can be a great way to promote your services and raise awareness of your brand. Consider publishing articles, info graphics and eBooks about popular financial topics to help customers learn about finance and discover the business. Answering questions and providing information can help teach customers the importance of your services.

5. CUSTOMER SUPPORT

Develop ways to provide customer support and help consumers with the unique issues they may be experiencing. Many companies hire specific team members to work in customer support departments, answering calls and responding to messages. Strong customer and technical support can show customers you care about their needs and encourage them to continue using your services.

6. DATA ANALYSIS

Data analysis is the process of gathering and assessing large amounts of information to gain actionable business insights. Financial service companies can track customer data to determine customer behaviors, needs and feelings. Then, marketers can collaborate with product development teams to solve any issues, optimize services and provide more value to customers.

7. CUSTOMER OUTREACH

Customer outreach is the process of communicating with customers and trying to increase customer engagement rates. Initiating a relationship with customers can help raise awareness about a business, encourage customer loyalty and improve customer retention rates. Financial service firms can perform outreach by offering resources like free consultations, webinars or financial management programs. They can also engage customers through email marketing strategies, like mailing lists.

8. RELATIONSHIP-BUILDING

Beyond digital engagement, financial businesses can practice relationship-building to connect with customers personally. As a marketer, salesperson or account manager, consider reaching out to customers personally to schedule meetings. These meetings could be to answer questions, give sales pitches or discuss business in general. Client relationship-building can occur over lunch and dinner dates, sports games or other social activities.

9. CUSTOMER FEED BACK

Customer feedback is essential for gauging customer satisfaction with a company's products and services. Conducting surveys over social media, email or in person can help you gather qualitative and quantitative data. You can then use this data to develop relevant promotional material.

10. CREATIVE MARKETING

Being creative is key to setting your marketing campaigns apart from competitors. Consider promoting your business mission and characterizing your brand with a specific social goal. Then, create and deliver emotional and powerful stories that display the company's work to reach this goal.

16.3. LOAN PROCEDURE

The loan approval & Disbursement process mainly consists of four simple steps:

- Step 1 –Appraisal
- Step 2 - Security Evaluation
- Step 3 - Loan Sanction
- Step 4- Disbursement

STEP I: APPRAISAL

1. Personal Interview: All the prospective borrowers are interviewed personally by the Manager. He is then explained the complete procedure for availing loan & all the necessary documents are called for.

2. Eligibility Status Check : A thorough review of documents that determine the eligibility of the prospective borrower, including proof of identity, address and income (such as voter's ID, PAN card, salary certificates, bank statements, income-tax returns, audited books of accounts), is carried out. Further, an Equifax Credit Information check/ CIBIL check is also performed simultaneously on the prospective borrower on their credit repayment habits.

3. Submission of documents: Once the proposed borrower meets the basic eligibility criteria, an application form containing various details including details under KYC norms is prepared and submitted by the applicant. Once this process is complete, a scrutiny of the documents submitted by the proposed borrowers was done by loan department.

4. Verification / Scrutiny: For prospective borrowers, our personnel visit the business premises and examine and ascertain whether the business is generating sufficient income to repay the loans. Similarly, for prospective salaried borrowers, our personnel visit the office of the prospective borrower for verification.

STEP II – SECURITY EVALUATION

1. Technical Evaluation: Our personnel obtain a technical valuation report from an internal valuers/independent and empanelled valuer for the asset to be financed. While the valuers provide an independent assessment of the current market value, our personnel generally adopt a conservative approach in valuing the asset.

STEP III – LOAN SANCTION

1. Determination of the amount of Loan to be sanctioned: Upon satisfactory completion of the process summarized above, our personnel determine the amount of

loan to be granted to the prospective borrower. Key determinants of the amount of loan that can be sanctioned are the IIR and the LTV. IIR is the ratio of the monthly installment to the total monthly income of the borrower. LTV is the ratio of the loan value to the appraised value of the security. The borrower is eligible to take a loan up to the amount as arrived by a standardized calculation.

2. Preparation of the Loan Proposal: Based on the above-mentioned scrutiny procedures, a loan proposal is prepared. The loan proposal includes a loan appraisal note, evaluation summary, and inspection and valuation report. If the loan proposal is satisfactory, it is forwarded by officials with recommendation on the loan amount. The interest rate to be levied on the prospective borrower is based on a Interest chart which is based on criteria such as the applicant's income profile, capacity to repay the loan, value of the property, marketability of the property, family background, etc.

3. Scrutiny of the Loan Proposal: Loan proposals are scrutinized by head office officials.

4. Approval / Sanction of the Proposed Loan: If the proposal meets with the required criteria, then the loan is approved by the sanctioning authority.

5. Preparation of Loan sanction letter: Pursuant to sanction of the loan by the head office, a loan sanction letter with the terms of the sanction is communicated to the borrower and at this point the borrower is required to submit original documents in relation to the security.

6. Guarantor's credit worthiness : A guarantor, who should be a creditworthy person either a businessmen or a government employee, is also asked to be a party to the contract & liable to the company in case of any default in repayment of loan installment by the borrower.

STEP IV – LOAN DISBURSEMENT

1. Execution of Loan Agreement and Disbursement of Loan: The loan amount is disbursed to the borrower only after the loan agreement is executed and the agreement is signed. Prior to loan disbursement, our Company also completes other formalities such as collection of post dated cheques from borrowers in respect of the monthly installments, etc.

16.4. COLLECTION AND RECOVERY OF FSC LOAN

Debt recovery and debt collection are similar terms with one small, but very important distinction. The difference is who is trying to retrieve a debt. Debt collection is when a creditor attempts to recover consumer credit and loans that have not been paid back by a customer. Debt recovery is when a loan – such as a credit card balance – continues to go unpaid, and the creditor hires a third party, known as a collection service, to focus on collecting the money. Debt recovery is sometimes called loan recovery, but the purpose of both is exactly the same: find a way to make you pay back the money you borrowed.

Debt (or loan) recovery is important because it is directly correlated to your credit score. If a debt recovery service is contacting you, it means there is a record that you have defaulted on a loan and currently have delinquencies. These delinquencies get reported to the credit bureaus, damaging your credit score, which can potentially hurt any future loan opportunities.

There are several steps in the debt recovery process, and it is important to know what to expect when a debt recovery agent contacts you. In fact, because financial debt can be a sticky situation, legislation has been established to guide the debt recovery process and ensure that consumers are protected from harassing debt recovery practices.

16.5. DEBT RECOVERY TERMINOLOGY:

- **Debtor:** Person obligated to pay back money that was borrowed.
- **Creditor:** Person who extends credit with an agreement that the money loaned will be paid back.
- **Third party collector:** Person or service that is contracted to collect debts for a creditor.

16.6. THE DEBT COLLECTION PROCESS

The debt collection process starts when there is a missed payment on a credit card or loan. The debtor has 30 days from the bill due date (not the billing date) to make the payment before it is reported to the credit bureaus. During this time, the creditor will try to contact the debtor by phone, email, or letter to get their payment and any late fees. It's best to take care of the debt during this 30-day window. The debtor can explain his/her situation and set up a repayment plan.

After 30 days, the debt is handed off to another department at the same company that specializes in retrieving delinquent debt. This isn't a collection agency, just a department within the lending company. They could report your delinquency to a credit bureau and shut down your credit card account.

After 180 days, the creditor usually will contract the debt or write it off their books and sell it to a debt collection agency. Be aware that the creditor might contract or sell the debt at any time before the 180 days, so it's best to act sooner rather than later.

16.7. PHASES TO THE DEBT COLLECTION PROCESS

Generally, there are three phases to the debt collection process:

1. For the first six months of your delinquency, you usually will deal with your creditor's internal collector, which is sometimes referred to as a first-party agency (you, the debtor, are the second party). This may be an ideal time to try and settle your debt, since no middleman is involved and your lender still has an incentive to maintain a positive relationship with you.

2. Once your lender has decided that you aren't going to repay your debt, it will be assigned to an outside organization, sometimes known as a third-party agency. At this point, the debt is still owned by, and owed to, the original creditor. If the third-party

agency is successful in recovering all or part of the debt, it will earn a commission from your creditor, which can either be in the form of a fee, or a percentage of the total amount owed.

3. In the third phase of the process, your original creditor writes off your debt and sells it — often for pennies on the dollar — to an outside collection agency, sometimes known as a debt buyer. Your creditor is no longer involved. The collection agency is still trying to recoup as much of the debt as it can, in order to turn a profit on its purchase.

In recent years, creditors have been turning over more of their delinquent accounts to debt-collection law firms, rather than to traditional bill collectors. The idea is that communication from a lawyer makes a greater impression, thereby increasing the possibility of paying collections.

16.8. INITIAL CONTACT FROM DEBT COLLECTORS

Debt collectors are permitted to contact you by every communication system available – phone, letters, email or text message – but there are rules they must follow or they are in violation of the Fair Debt Collection Practices Act (FDCPA). Those rules include:

- They must identify themselves as a debt collection agency and give their name and the address for the collection agency.
- They must tell you the name of the creditor (company or person you owe), the amount you owe and how you can dispute the debt or seek verification of the debt.

- If the debt collector does not provide verification information on the first communication with you, he must send written notice with that information within five days of the initial contact.

16.9. DEBT COLLECTION LAWS

Although collectors are legally entitled to attempt to collect all owed debts, they are restricted in the methods they can employ by the Fair Debt Collection Practices Act. The law passed Congress in 1977 as an amendment to the Consumer Credit Protection Act of 1968.

THE FDCPA:

- Prohibits a collection agency from discussing your debt with your family, friends, neighbors or employer.
- Limits the times of day collectors can call you.
- Prohibits the use of slurs, obscenities, insults or threats.
- Provides remedies for consumers who wish to stop collection agencies from all contact.
- Requires collectors to verify all debts and end collection procedures if verification is not forthcoming.

While the original creditors are not covered by the provisions of the act, all third-party bill collectors and lawyers who are regularly engaged in the collection of debts are

covered. In addition, many states have statutes that regulate the practices of bill collection agencies, with some requiring them to be licensed, registered or bonded.

A majority of U.S. collection agencies — approximately 3,200 of them — belong to ACA International, the world's largest nonprofit trade group representing collection agencies, creditors, debt buyers, collection attorneys and other industry service providers. The ACA requires its members to abide by all laws and regulations, as well as its own codes of ethics and operations.

The ACA requires its members to "treat consumers with consideration and respect" and "communicate with consumers with honesty and integrity." It also restricts collectors from engaging in "dishonorable, unethical or unprofessional conduct … likely to deceive, defraud, or harm a consumer."

16.10. LEGAL ACTION VS DEBT COLLECTORS

If a debt collection agency has violated your rights under the FDCPA through repeated contact, abuse, threats, misleading information or false representation, you can sue them in state court. The burden of proof is on you, but if the judge rules in your favour, you can be awarded $1,000 in statutory damages plus attorney's fees. If you take this route, it is best to hire an attorney to represent you. If you take the case to state court, you must do so within one calendar year from the date of the violation.

If you want to handle the matter yourself, you can sue in small claims courts. The process is faster, but compensation for damages usually is limited.
Many disputes with debt collectors wind up in arbitration hearings. Businesses, especially credit card and cell phone companies, have clauses in contracts with consumers that say disputes must be settled in arbitration.

16.11 DEBT RECOVERY PROCESS

Once the debt belongs to a collection agency, the creditor will send the claim information and supporting documentation to the debt collector noting your failure to pay according to the terms of the agreement. After the claim is reviewed and accepted by the debt collection service, the recovery process begins with a demand letter being sent to the debtor and an acknowledgement letter being sent to the client (creditor who enlisted the collection service).

The account is now active, and the debt recovery efforts swing into high gear through several methods.

The first is usually via telephone in an attempt to arrange payment for the outstanding balance and ensure that the payments are realized. If the debtor does not cooperate with resolving the debt, the debt collection service updates the client with details on forwarding the claim to the affiliated attorneys. The forwarded claim is signed by the client and sent to the affiliated attorneys, and if attorneys recommend legal action, suit requirements are provided.

If the client authorizes legal action and agrees upon suit requirements, the lawsuit is prepared and filed. If the client doesn't want to pursue legal action, the claim is worked on

for an additional 60 days by the debt collection service and then closed. If debtor files a response, the discovery process begins, and a trial date is set. If debtor does not respond, a default judgment is filed by the attorneys. If a judgment is awarded in the client’s favor, attorneys will file a Writ of Attachment, attempt to locate debtor’s assets, and initiate steps to satisfy the judgment, which most often comes in the form of bank levies, garnishments, liens, etc.

16.12. SUMMARY

Marketing finance services, particularly loans offered by finance service companies, involves a strategic approach tailored to the needs of potential borrowers while also aligning with the company's objectives. Finance service companies often target individuals or businesses in need of capital for various purposes such as starting a business, expanding operations, or personal investments. Finance service companies need to clearly define the unique selling points of their loan products. This involves highlighting aspects like competitive interest rates, flexible repayment terms, quick approval processes, or specialized loan options tailored to specific industries or needs. Finance service companies utilize various digital marketing channels such as social media, search engine optimization (SEO), content marketing, email campaigns, and pay-per-click advertising to reach and engage potential borrowers. Compliance with regulatory requirements and transparent communication regarding loan terms, fees, and repayment obligations are critical in gaining the trust of potential borrowers. Finance service companies must ensure that their marketing materials comply with relevant laws and regulations governing financial services. In summary, marketing finance services, particularly loans offered by finance service companies, requires a comprehensive understanding of the target audience, effective positioning of loan products, leveraging digital marketing channels, building thought leadership, fostering partnerships, maintaining strong customer relationships, ensuring compliance, and continuously analyzing and optimizing marketing efforts to achieve business objectives.

16.13. KEY WORDS

Financial Services: Services provided by companies that manage money, including banking, investment, insurance, and lending.

Loan Products: Various types of loans offered by financial service companies, such as personal loans, business loans, mortgage loans, etc.

Marketing Strategy: A plan developed by financial service companies to promote their loan products, attract customers, and achieve business goals.

Digital Marketing: Marketing efforts conducted through digital channels such as websites, social media, search engines, email, and online advertising.

Branding: Creating a unique identity and image for a financial service company's loan products to differentiate them from competitors and resonate with customers.

Customer Segmentation: Dividing the target audience into smaller groups based on shared characteristics or interests to tailor marketing strategies and messages.

Interest Rates: The percentage charged by financial service companies on loans, representing the cost of borrowing money.

Cross-Selling Opportunities: Identifying and promoting additional loan products or financial services to existing customers based on their needs, preferences, and financial profiles.

16.14. SELF-ASSESSMENT QUESTIONS

Essay type questions

1. What is the financial service marketing and write the Strategies for financial service marketing?
2. Collection and recovery of Financial Service Company loans?
3. Explain the phases to the debt collection process and describe the debt collection laws?

Short type questions

1. Mention the steps involved in the loan procedure?
2. Explain the debt recovery process?
3. Discriminate Legal action vs. debt collectors.

16.15. SUGGESTED READINGS

1. Philip Kotler and Kevin Lane Keller: Marketing Management, Pearson, New York, 2020.
2. Gary S. Becker and Guity Nashat Becker: The Economics of Life: From Baseball to Affirmative Action to Immigration, How Real-World Issues Affect Our Everyday Life, McGraw-Hill Education Publications, New York, 1997.
3. Mary Beth Armstrong: The Loan Officer's Handbook for Collection and Recovery, John Wiley & Sons Publications, Hoboken, NJ, 2008.
4. Steve Albrecht and Earl Wilson: Financial Statement Fraud: Prevention and Detection, John Wiley & Sons Publications, Hoboken, NJ, 2013.
5. J. A. Samad and S. M. Mohiuddin: The Operation and Regulation of Non-Bank Financial Institutions, Routledge Publications, New York, 2017.

Dr. P. Mercy Kumari

LESSON - 17
CASE STUDIES ON BANKING AND OTHER FINANCIAL SERVICES

Aims and Objectives:

After completing the lesson, we student is able to demonstrate:

- How to prepare a Case
- Drafting the case
- Finalizing the case
- Different model case studies on Banking

Structure

17.1 Introduction
17.2 Preparing the Case
17.3 Drafting the Case
17.4 Finalizing the Case
17.5 Model Case studies
17.6 Summary
17.7 Key Words
17.8 Self-Assessment Questions

17.1 INTRODUCTION

A case study analysis requires you to investigate a business problem, examine the alternative solutions, and propose the most effective solution using supporting evidence. Case studies are used in many professional education programs, primarily in business school, to present real-world situations to students and to assess their ability to parse out the important aspects of a given dilemma. In general, a case study should include, in order: background on the business environment, description of the given business, identification of a key problem or issue, steps taken to address the issue, your assessment of that response, and suggestions for better business strategy. Solving of cases with help these theories often become difficult we have to track our own ways. There is no ideal path to solve the realistic problems but looking forward I traced new way to solve it. It may not be ultimate option to solve your case but guide you in right direction where do you have to be. At the first stage you have to pass through the four stages namely, Study, Contemplate, Decide and Implement

The most difficult part of solving the case study is to understand the case where majority of student fails. So as to overcome from this, above four stages can be beneficial. Presently, an average Indian student does not have specific procedure to solve the case study. This procedure has different logical steps. A comprehensive list of steps to attain the best possible solution for the case is as follows. Case: “Ram is a Bank Manager, yesterday at 6:30 pm he gets an urgent appointment from his client for what he was waiting for 20 days, this deal may increase his bank deposits volume, he has to meet him tomorrow by 9:30 to 11:00 am. But tomorrow he need to drop

his daughter at the examination centre at 10.00 am" With the help of case mention above we can better understand all the steps.

17.2 PREPARING THE CASE

When writing a business case study analysis, you must first have a good understanding of the case study. Before you begin the steps below, read the business case carefully, taking notes all the while. It may be necessary to read the case several times to get all of the details and fully grasp the issues facing the group, company, or industry. As you are reading, do your best to identify key issues, key players, and the most pertinent facts. After you are comfortable with the information, use the following step-by-step instructions (geared toward a single-company analysis) to write your report. To write about an industry, just adapt the steps listed here to discuss the segment as a whole.

Step 1: Investigate the Company's History and Growth
A company's past can greatly affect the present and future state of the organization. To begin, investigate the company's founding, critical incidents, structure, and growth. Create a timeline of events, issues, and achievements. This timeline will come in handy for the next step.

Step 2: Identify Strengths and Weaknesses
Using the information you gathered in step one, continue by examining and making a list of the value creation functions of the company. For example, the company may be weak in product development but strong in marketing. Make a list of problems that have occurred and note the effects they have had on the company. You should also list areas where the company has excelled. Note the effects of these incidents as well.
You're essentially conducting a partial SWOT analysis to get a better understanding of the company's strengths and weaknesses. A SWOT analysis involves documenting things like internal strengths (S) and weaknesses (W) and external opportunities (O) and threats (T).

Step 3: Examine the External Environment
The third step involves identifying opportunities and threats within the company's external environment. This is where the second part of the SWOT analysis (the O and the T) comes into play. Special items to note include competition within the industry, bargaining powers, and the threat of substitute products. Some examples of opportunities include expansion into new markets or new technology. Some examples of threats include increasing competition and higher interest rates.

Step 4: Analyze Your Findings
Using the information in steps 2 and 3, create an evaluation for this portion of your case study analysis. Compare the strengths and weaknesses within the company to the external threats and opportunities. Determine if the company is in a strong competitive position, and decide if it can continue at its current pace successfully.

Step 5: Identify Corporate-Level Strategy
To identify a company's corporate-level strategy, identify and evaluate the company's mission, goals, and actions toward those goals. Analyze the company's line of business and its subsidiaries

and acquisitions. You also want to debate the pros and cons of the company strategy to determine whether or not a change might benefit the company in the short or long term.

Step 6: Identify Business-Level Strategy
Thus far, your case study analysis has identified the company's corporate-level strategy. To perform a complete analysis, you will need to identify the company's business-level strategy. (Note: If it is a single business, without multiple companies under one umbrella, and not an industry-wide review, the corporate strategy and the business-level strategy are the same.) For this part, you should identify and analyze each company's competitive strategy, marketing strategy, costs, and general focus.

Step 7: Analyze Implementations
This portion requires that you identify and analyze the structure and control systems that the company is using to implement its business strategies. Evaluate organizational change, levels of hierarchy, employee rewards, conflicts, and other issues that are important to the company you are analyzing.

Step 8: Make Recommendations
The final part of your case study analysis should include your recommendations for the company. Every recommendation you make should be based on and supported by the context of your analysis. Never share hunches or make a baseless recommendation.

You also want to make sure that your suggested solutions are actually realistic. If the solutions cannot be implemented due to some sort of restraint, they are not realistic enough to make the final cut. Finally, consider some of the alternative solutions that you considered and rejected. Write down the reasons why these solutions were rejected.

Step 9: Review
Look over your analysis when you have finished writing. Critique your work to make sure every step has been covered. Look for grammatical errors, poor sentence structure, or other things that can be improved. It should be clear, accurate, and professional.

17.3 DRAFTING THE CASE

Once you have gathered the necessary information, a draft of your analysis should include these general sections, but these may differ depending on your assignment directions or your specific case study:

1. Introduction
   - Identify the key problems and issues in the case study.
   - Formulate and include a thesis statement, summarizing the outcome of your analysis in 1–2 sentences.
2. Background
   - Set the scene: background information, relevant facts, and the most important issues.
   - Demonstrate that you have researched the problems in this case study.

3. Evaluation of the Case
    - Outline the various pieces of the case study that you are focusing on.
    - Evaluate these pieces by discussing what is working and what is not working.
    - State why these parts of the case study are or are not working well.
4. Proposed Solution/Changes
    - Provide specific and realistic solution(s) or changes needed.
    - Explain why this solution was chosen.
    - Support this solution with solid evidence, such as:
        - Concepts from class (text readings, discussions, lectures)
        - Outside research
        - Personal experience (anecdotes)
5. Recommendations
    - Determine and discuss specific strategies for accomplishing the proposed solution.
    - If applicable, recommend further action to resolve some of the issues.
    - What should be done and who should do it?

17.4 FINALIZING THE CASE

After you have composed the first draft of your case study analysis, read through it to check for any gaps or inconsistencies in content or structure:

- Is your thesis statement clear and direct?
- Have you provided solid evidence?
- Is any component from the analysis missing?

When you make the necessary revisions, proofread and edit your analysis before submitting the final draft

17.5 MODEL CASE STUDIES

17.5.1 Model Case study Example

Let's say that Roy, who runs a high-end car workshop, needs particular parts to repair one of his client's cars. Unfortunately, the car is a Japanese model and, at the moment, he can only get the parts from Japan. So, he decides to use a wire transfer to pay the Japanese manufacturer for the parts. He goes to the bank and deposits the money plus fees. The other company receives it in Japan and sends the parts.

To make the wire transfer, Roy's bank, a local U. S.-based institution, sends the money using the Society for Worldwide Interbank Financial Telecommunication (SWIFT). The correspondents in the SWIFT network connect both sides for a fee using the system. It receives the money and then transfers it to the other bank, connecting each side and completing the transaction.

17.5.2 Model Case study Example

Late in 2022, Iraq started experiencing an extremely strong financial crisis which ultimately resulted in the depreciation of its currency. Their currency dropped from 1,475 Dinars

for a Dollar in September 2022 to 1,580 Dinars in January 2023. Therefore, the Central Bank of Iraq had to follow the regulations of the U.S. correspondent banks to be able to continue accepting transfers.

17.5.3 Model Case study on The Client

The client is a business leader in developing financial leads and mandates for their global customers. Based out of Singapore, the client helps global investment firms get quality financial leads.

Client's Requirement & Challenges

The requirement was to retrieve and obtain financial information from business owners belonging to the European and African markets through Telecalling. Initially, the client was skeptical about sharing information (database). However, once they were introduced to our team, implementation process, and the data security measures, they were comfortable and eventually handed over their database to us to proceed with the Telecalling.

The Solution

As a part of our telemarketing services, our call center executives provided personal service by contacting directly to the target audience. They explained the issues very well and achieved the measurable result of getting at least 5 high-value leads every day. This way, the client was able to provide quality leads to their customers.

- Established direct contact with the customers through Telecalling
- Provided interactive and personal services
- Explained issues to find out the financial whereabouts of the target audience
- Helped resolve prospect's queries
- Extended market reach through references
- Achieved measurable result of 5 leads per day
- Were able to set up appointments to drive the further lead generation process

The Results

With the expertise of our operations' team and full support from the clients' end resulted in involving 10 capable resources within a week. The momentum took off with an amazing start that later surpassed the client's expectations. Our support staff ensured that the client always receives strong leads.

Outsource Telemarketing Lead Generation Services to Flatworld Solutions

Flatworld Solutions is a leading call center firm that specializes in telemarketing and lead generation services. We can help a client with workforce management, call center support, process improvement, inbound & outbound call center services and more. With us, you will find the best course to improve your telemarketing operations. We use advanced tools, technologies, and processes to improve the overall lead generation metrics

17.5.4 Model Case study on Customer Service

There is a branch opened 20 yea back in a Metro Centre. The area is a residential one and has several high profile and well to do people living in the area. Due to existence of such good customer several other banks, including a foreign bank, have opened their branches in the area.

On entering the branch one finds an atmosphere of orderliness with proper directions to customer. There is information about the various products of the bank displayed along with the requirements and formalities for availing such services. On approaching the 'May I help you' counter the peon sitting there quickly deals with the customer and then looks after the work allotted to him. He is well aware of all the products of the bank and directs you to the right peon for the rest of the work. He provides you with a pre-prepared set of Account Opening Form for filling up and helps the illiterates in completing the formalities. He is also accepting cheques in clearing and transfer from the customer.

The branch has a regular practice of sending non-penalized cards to customer after they have opened their accounts. The drafts issued by the branch are delivered to customer in banks envelopes and normally delivered to customer in 20 minutes. Every staff member of the branch has been given a set of queries raised by administrative offices/auditor, relating to their job profile. This avoids unnecessary correspondence and other delay causing facto in customer service.

The branch has extended customer hours and has effectively marketed this feature to solicit customer. As such there are customer in the branch throughout the day. The branch manager has started a practice of giving small mementos to the best employee of the branch every month. Recently, the branch tied up with various principals of schools for opening accounts of students with photographs. These students were issued ATM cards immediately on opening of account. Due to this fact, the ATM hits have increased from 25 to 175 per day. The branch follows the single window concept for all common services.

The branch has three floor and there are cash counter on all the floor. There is a senior citizen counter also on the ground floor. There is another branch located in a posh colony. It has an ATM and the ATM cum debit cards have been issued haphazardly due to pressure from administrative offices. The branch was brought under Core Banking Solutions a long time back but there is no single window concept even for the most common services like SF, CA etc. A visit to the branch shows that the staff is moving around the branch chatting with each other but they are not busy due to work. The ATM hits are about 15 per day.

The peon sitting at the 'May I help you' counter is not up to date on the products and services of the Bank. He has been given the additional work of attending to telephone calls and also other miscellaneous work. The passbook updating counter is the fit casualty in case of absence/leave of staff. The Administrative Office keeps calling the branch for information regularly and both the branch manager and second man remain busy in providing such information. As such, they hardly have time for attending to customer. The branch timings have been changed from 8.30 a.m. to 8.30 p.m. for the last 4 months but there has been no significant increase in business. In fact, very few customer are aware of the services offered during these extended hours. The printer of the branch remains out of service most of the time. The staff is rude in attending to

customer and they do not have any contingency plan in case of failure of connectivity. In fact, all the staff vanish from their seats when there is no connectivity. The Accounts Opening Forms and other relevant forms are not available on the counter and the customer are seen moving from one counter to the other for obtaining cash deposit and withdrawal forms. The managerial staff is not aware of even the basic menu options of the CBS software. This branch is surrounded by Citibank and two other nationalized banks. There are more than 10 banks in one-kilometre radius. A few office of the branch have a complaint with respect to PAF assessments rated by the final authorities. Though they are very hardworking and have contributed their might they were given only a good rating. This has affected their morale.

Question

As a Manager/Sr Manager posted at administrative office, you had visited both the branches along with your senior officials. Now the authorities have posted you at the second branch with a lot of hope and anticipation. Give a presentation on your strategy for the branch for the next one year.

17.5.5 Model Case study on Co-operative Bank Scams in India

"The objective of co-operative banking is to create enduring and sustainable financial institutions which remain responsive to the credit needs of weaker sections." - RBI Report on Trend and Progress of Banking in India, 2000-01

"There has been a mushrooming of co-operative banks in the country. Low barriers to entry spurred individuals with vested interests to start such banking ventures with a view to milk the depositors funds." – Suresh Hemmady, chairman of the Shamrao Vithal Co-operative Bank

"They are non co-operatives under the camouflage of co-operatives." – Rama Reddy, President of Hyderabad based Co-operative Development Foundation

The case, "Co-operative Bank Scams in India" gives an insight into the various scams and malpractices in co-operative banks in India and their implications on the Indian financial sector. The case begins with a history of co-operative banking in India. It briefly describes the structure of co-operative banks and their characteristics. The case then discusses in brief the scams that surfaced in four co-operative banks, viz., Madhavpura Mercantile Co-operative Bank (MMCB), Krushi Co-operative Urban Bank (KCUB), Charminar Co-operative Urban Bank (CCUB) and Nagpur District Central Co-operative Bank (NDCCB) in 2001-02. The case also discusses how to revive the functioning of co-operative banks in India.

Many of these banks did not adhere to the prudential norms prescribed by the Reserve Bank of India (RBI). The Madhavapura Mercantile Co-operative Bank (MMCB) had invested a huge amount in the equity market which was almost equal to its deposit base, thus, violating the RBI norms relating to exposure to the equity market. Another bank, the Krushi Co-operative Urban Bank (KCUB) had issued loans and advances amounting to ` 530 million as against its deposit base of ` 350 million. Not only that, most of its loans had not been secured. Similarly, the Charminar Co-operative Urban Bank (CCUB) faced liquidity problems due to indiscriminate

lending to big borrowers against worthless land. More recently the Nagpur District Central Co-operative Bank (NDCCB) was involved in fraudulent dealings in government securities through brokers. Co-operative banks were established in India to facilitate rural credit, and to cater to the needs of small farmers and businessmen.

They were popular with middle and lower income groups because of the high interest rates they offered as compared to commercial banks. However, with the passage of time, most co-operative banks lost their purpose. Excessive state control and politicisation further led to their deterioration. By the 1990s, none of the public or private sector banks were willing to deal with co-operative banks and thus even otherwise healthy co-operative banks were facing a tough time. In 2001-2002, many co-operative banks were rocked by scams that exposed the malpractices in these banks.

17.5.6 Co-operative Banks – A Profile

In the early 20th century, the availability of credit in India, more particularly in rural areas was non-existent. There was no organized institutional credit for agricultural and related activities. People in the rural areas largely depended on money lenders who lent money at very high rates of interest. Thus, there was need to create an institution which would cater to the needs of ordinary people and was based on the principles of co-operative organisation and management. In 1904, the first legislation on co-operatives was passed. In 1914, the Maclagen committee suggested a three tier structure for co-operative banking i.e. Primary Agricultural Credit Societies at the grass root level, Central Co-operative Banks at the district level and State Co-operative Banks at the State or apex level. Co- operative banks were expected to serve as substitutes for money lenders, and provide both short-term and long-term institutional credit at reasonable rates of interest.

Co-operative banks operate both in urban and non-urban centres. The urban areas are served by the Primary (Urban) Co-operative Banks (PCBs/UCBs) whereas the rural areas are largely served by two sets of institutions, the PACSs and LDBs, dispensing short-term and long-term credit, respectively. UCBs have a three-tier structure with the State Co- operative Banks (SCBs) at the apex level, the District Central Co-operative Banks (CCBs) at the intermediate level and the Primary Agricultural Credit Societies (PACS) at the grass root level. Under the long-term credit structure, State Co-operative Agriculture and Rural Development Banks (SCARDBs) are at the apex level and the Primary Co-operative Agriculture and Rural Development Banks (PCARDBs) are at the base level. MMCB was established on October 10, 1968 in Ahmedabad, Gujarat, to cater to the varied financial needs of wholesale grocery traders in Ahmedabad's Madhavpura spice market.

The bank was awarded the status of a scheduled bank in 1999, which permitted it to expand its banking activities outside Gujarat. MMCB had 22 branches and was undertaking regular banking activities. It had a deposit base of ` 10.56 billion in 1999-00, of which ` 6 billion was from other co-operative banks and organizations, while the rest was from the public. The bank received huge deposits after being awarded the status of a scheduled bank by RBI. KCB, a Hyderabad based bank was registered on April 1, 1998. On March 31, 2000, the bank had a paid-up share capital of ` 10.2 million. Its deposits comprised 92.41% term deposits, 5.42% current deposits and 2.17% savings deposits.

17.5.7 Model Case study on Scams in Co-operative Banks

In 2001, MMCB was rocked by a scam. The bank had lent ` 10.5 billion to the equity market. There was no security or collateral issued against the money taken as a loan. This exposure was almost equivalent to its deposit base of ` 10.56 billion in the financial year 1999-2000. Its advances during the year were ` 7.78 billion. The bank violated the RBI norms which stated that a bank's exposure to the stock market cannot exceed 5% of its outstanding loans. Panicky depositors began withdrawing money on hearing reports that the bank had lent heavily in capital markets and that these loans had turned difficult to deal with, due to a steep fall in share prices. Only three entities accounted for the 10.5 billion. No security or collateral was deposited with the bank. While ` 8.3 billion was lent to stock broker Ketan Parekh and his companies, ` 2 billion and ` 20 million were lent to Bombay Stock Exchange (BSE) broker, Mukesh Babu, and the Maniar group respectively.

Reviving Co-operative Banking

Co-operative banks have for long been the back bone of rural banking. Since their inception, they have been doing excellent work in the field of rural and co-operative banking. The recent scams in co-operative banks have been a jolt to co-operative banking system. Many analysts have suggested that co-operative banks should be brought under the complete control of RBI ending the dual control by the State governments and RBI-NABARD. According to N. Patel, Vice-Chairman of Gujarat Urban co-operative Banks Federation, control by a single authority will ensure smooth governance of co-operative banks. Some analysts also feel that interference from the registrar of co-operatives should be minimized.

Question: Write down the case fact related to the scams in the urban co-operative banks.

17.5.8 Model Case study on ICICI Bank – Innovations in Microfinance

"ICICI Bank is one bank that has developed a very clear strategy to expand the provision of financial products and services to the poor in India as a profitable activity." – Haruhiko Kuroda, President, Asian Development Bank

The case describes microfinance initiatives of ICICI Bank, the largest private sector bank in India. In spite of being a new entrant, ICICI Bank has been highly successful in the microfinance sector, primarily because of its innovative microfinance business models.

The case discusses some of these models including Bank led & Partnership model. Other microfinance ventures of ICICI Bank are also explained in detail. The case presents how ICICI Bank has made microfinance a viable business proposition for banks.

Forays in Microfinance

Lakshmi, a 22-year-old school dropout, lived in a remote village of Tamil Nadu. Instead of getting married and starting a family like any other village girl of her age in India, she wanted to set up on her own business. Lakshmi started an Internet kiosk in her village, offering services like e-mail, Internet chat and tips on health and education. The kiosk was partially financed by ICICI Bank and was set up in association with n-Logue Communications. Latha, a 29-year-old married woman with three children borrowed ` 18,000 to set up a small provision store in Kothaipalli, a small village, in the north of Andhra Pradesh. Within a year, she started earning ` 3,500 a month from

the store. With this money, she was able to provide her children a good education at a local private school. She was a part of a self help group in Andhra Pradesh which received financial assistance from ICICI Bank. These are real-life examples to illustrate how the micro-lending initiatives of ICICI Bank affected the lives of poor women in India.

By becoming a part of self-help groups, several rural women were able to move out of poverty. Apart from financial benefits, the initiatives helped the women to develop self confidence, improve their communication skills and raise their position in society. In India, 400 million people spread across more than six million villages are estimated to be in need of micro-financing. The organized financial sector caters to the need of about 20 million people. ICICI Bank's micro credit initiatives involved lending small amounts to the people below poverty line. It provided basic banking services like savings and withdrawal along with micro-investment products like mutual funds. This provided poor people with safer avenues for saving with little volatility. ICICI Bank was also instrumental in designing new structures through which Microfinance Institutions (MFIs) and Non-governmental Organizations (NGOs) could overcome capital constraints and expand their reach.

The structures included buying the microfinance portfolios of MFIs either on a selective basis or buying the complete loans of a branch or a particular area, and also entering into partnership arrangements with MFIs. This helped in leveraging the operational strength of NGO/MFI with the financial strength of ICICI Bank. In the world's largest securitization deal, ICICI Bank purchased a portfolio of 42500 loans worth US$ 4.3 million from Share Microfin Limited in 2004.

Background Note

In March 2004, the cumulative disbursements to SHGs stood at ` 39 billion. According to industry experts, the demand for microfinance in India was estimated at about ` 300 billion. This meant there was a huge unmet gap between demand and supply. In the past, high demand and low supply of micro-credit was blamed on the limited efforts of major Indian financial institutions to reach the poor. Banks considered small loans as a statutory obligation rather than a business opportunity. Mainstream financial institutions considered these loans as ones that were difficult to recover, unprofitable and involving high transaction costs.

These loans were perceived to carry high risk as they had high default rates; the borrowers usually did not have any viable income generating opportunities nor did they possess any collateral guarantee. To fill the huge gap between demand and supply, an environment that was conducive for microfinance providers was required. ICICI Bank was promoted in the year 1994 as the banking division of Industrial Credit and Investment Corporation of India Limited (ICICI).

ICICI was a developmental financial institution incorporated in the year 1955, as a joint initiative of Government of India, the World Bank and representatives of the Indian industry. By the 1990s, ICICI had emerged as a diversified financial group that offered a wide range of financial products through a network of subsidiaries and affiliates. In April 2002, ICICI merged with ICICI Bank.

Bank Led Model

The bank led model was derived from the SHG-Bank linkage program of NABARD. Through this program, banks financed Self Help Groups (SHGs) which had been promoted by NGOs and government agencies. ICICI Bank drew up aggressive plans to penetrate rural areas through its SHG program. However, rather than spending time in developing rural infrastructure of its own, in 2000, ICICI Bank announced merger of Bank of Madura (BoM), which had significant presence in the rural areas of South India, especially Tamil Nadu, with a customer base of 1.2 million and 77 branches. Bank of Madura's SHG development program was initiated in 1995. Through this program, it had formed, trained and initiated small groups of women to undertake financial activities like banking, saving and lending. By 2000, it had created around 1200 SHGs across Tamil Nadu and provided credit to them.

Partnership Model

The SHG program had been fairly successful in several states of India, but the reach was limited only to those areas where the bank's branches were operational. The partnership model of ICICI Bank aimed at reaching those areas where the bank did not have any branches. This model aimed at synergizing the comparative advantages and financial strength of the bank with social intermediation, mobilization power and infrastructure of MFIs and NGOs. Through this model, ICICI Bank could save on the initial costs of developing rural infrastructure and micro credit distribution channels and could take advantage of the expertise of these institutions in rural areas. Initially, ICICI Bank started off by lending to MFIs and NGOs in order to provide the necessary financial support to their activities.

Later, ICICI Bank came up with a plan where the NGO/MFI continued to promote their microfinance schemes, while the bank met the financial requirements of the borrowers.

Other Microfinance Initiatives

As a part of microfinance initiatives in the agriculture sector, ICICI Bank developed Farmer Service Centers (FSC). An FSC was managed by an agricultural input supply company which supplied inputs like seeds and technical knowhow to the farmers. FSCs were also managed by an extension service organization which provided inputs, credit and technology or by an NGO that provided all the services that farmers needed for their agricultural needs. Working in close association with farmers, FSCs provided them with services like advice on seeds, sowing techniques, pest control, weed control, usage and dosage of herbicides, pesticides and fertilizers and other services associated with agriculture. The FSCs also provided crop-related information and services to farmers, apart from facilitating the sale of agricultural produce. The FSCs arranged to procure the produce through agents and sold it in organized agricultural markets thus getting better realization.

The Future

ICICI Bank plans to use the services of over 100,000 agents for its various microfinance initiatives. The bank has encouraged direct sales agents to market microfinance products into rural areas. These agents contact several borrowers, thus expanding the reach of ICICI Bank at a low cost. Taking the FSC initiative further, ICICI Bank plans to provide farmers credit from sugar

companies, seed companies, dairy companies, NGOs, micro-credit institutions and food processing industries.

SIG has been involved in a project in the southern state of Tamil Nadu to find out how wireless technology can be applied in the development of low cost models of banking. Another plan to increase the reach in rural areas is to launch mobile ATM services. ICICI Bank branded trucks have started carrying ATMs through a number of villages.

Question
Provide a business model of Microfinance, and explain how to make microfinance a viable business option.

17.5.9 Model Case study on The Impact of Non-performing Assets on Profitability of State Bank of India

The country's largest commercial bank is the State Bank of India. The bank has a network of 52 overseas offices spread over 31 countries covering all the time zone and has correspondent relationship with 720 foreign banks. The bank recently incorporated a subsidiary State Bank of India Life Insurance Company Ltd (SBI Life) for its foray in to the Insurance business. Expansion was the main theme for banks and not consideration, which continued till the early nineties and as far as project financing is concerned, big financial institutions like IFCI, ICICI, and IDBI were the major players for the corporate world.

Assessment of Non-Performing Asset through Ratios
The following ratios were calculated to assess the effect of non-performing assets on the financial operations of the selected banks:
1. Ratio of net non-performing assets to net advances and the ratio of gross non-performing assets to gross advances
2. Ratio of operating expenditure to total income
3. Ratio of net profit to total assets
4. Ratio of net non-performing assets to total assets.

Non-performing asset management is one of the major areas of focus and the bank is making all efforts to bring down the net non-performing assets ratio to fewer than 3% in to 3 years time. A close monitoring the non-performing assets accounts, aggressive policy for recovery, compromise and settlement has yielded good results. In India, the regulation traditionally has been very strict and in the opinion of certain quarters, responsible for the present condition of bank, where non-performing assets are of high order. The multiplicity of policy and regulations that a bank has to work, which makes its operations even more complicated, sometimes illogical. Banks are supposed to play an important role in achieving the objective of economic institutional credit support to various regions and sectors. Due to heavy competition in the banking industry, particularly among the Public sector banks, the SBI and its Associates have to concentrate much on the development of resources and to accelerate the collection mechanism to make it viable to strengthen profitability and efficiency in a better way.

The banks should retain staff working in NPA management cells for a sufficiency long period to facilitate continuity in efforts to recover NPAs. Specialized teams should be deployed

for recovery of advances, which have turned in to NPAs. The NPAs can be avoided at the initial stage of credit consideration by putting rigorous and appropriate credit appraisal mechanism. This is in order to recover the NPA debt; the judicial systems should revamp and is essential to enforce the SARFAESI act, with more stringer provisions to realize the securities and personal assets of the defaulters. Regular training on advanced techniques is necessary for personnel associated with the management of advances and NPAs.
Question
Analyse the case and write down the case facts. Also provide a Regression Analysis of NPAs from the case.

17.5.10 Model Case study on "The Indian Internet Banking Journey"

"We want to use the Internet to become a universal banking major."

In 2001, a Reserve Bank of India survey revealed that of 46 major banks operating in India, around 50% were either offering Internet banking services at various levels or planned to in the near future. According to a research report, while in 2001, India's Internet user base was an estimated 9 lakh; it was expected to reach 90 lakh by 2003. Also, while only 1% of these Internet users utilized the Internet banking services in 1998, the Internet banking user base increased to 16.7% by mid- 2000. Many of the major banks like ICICI, HDFC, IndusInd, IDBI, Citibank,

Global Trust Bank (GTB), Bank of Punjab and UTI were offering Internet banking services. Based on the above statistics and the analysts' comments that India had a high growth potential for Internet banking, the players focused on increasing and improving their Internet banking services. As a part of this, the banks began to collaborate with various utility companies to enable the customers to perform various functions online. ICICI's 'Infinity,' which was already a leader in the Indian Internet banking arena, began to allow its customers to pay their online real time shopping bills. HDFC, through its 'payment gateway' feature, allowed its Internet banking customers to make online and real time payments for their purchases. HDFC also entered into tie-ups with various portals to provide these business-to-customer (B2C) e-commerce transactions. As more banks entered Internet banking arena, the competition between the banks also increased. This compelled the banks to focus on capturing new markets and customers and adopting advanced technology on the Internet.

In the light of these developments, industry watchers remarked that Internet banking had arrived in a big way. Though it had a long way to go compared to the global standards, it was beginning to be seen as a replacement for the traditional banking set up in the future."

About Internet Banking
Globally, the banking business has always been in the forefront of harnessing technology to improve its services and efficiency. Banks have been quick to adopt rapidly evolving electronic and telecommunication technologies to deliver an extensive line of value added products and services to their customers. By the early 1990s, direct dial-up connections, personal computers, tele-banking and automated teller machines (ATMs) became common in most developed nations.

Internet banking evolved in the mid-1990s when Internet and the World Wide Web began to catch on. Soon, many major banks in the US and Europe began to use the Internet to provide banking services. Internet banking is a web-based service that enables the bank's authorized customers to access their account information. It allows the customers to log on to the bank's website with the help of a bank-issued identification and a personal identification number (PIN).

ICICI - Internet Banking Initiatives

ICICI bank was incorporated as a commercial banking company, by the Industrial Credit and Investment Corporation of India (ICICI), in May 1994. The first ICICI branch was started in June 1994 at Chennai. The bank provides an array of domestic and international banking services to enable national and international trade and business, investment and foreign exchange and treasury services. Right from its inception the bank focused more on incorporating advanced technology. The bank operated the largest chain of ATMs in the country, which amounted to more than 450 in 2000. All the bank's branches were fully computerized and networked through V-SAT5 technology.

The Future

Despite the rosy predictions and increased corporate activity, the Indian Internet banking system is facing many hurdles. The problems include operational risks, security risks, system architecture risks, reputational risks and legal risks. Apart from the security issues, there are a host of other problems like:

- PC user base in India is extremely low compared to global standards.
- The Internet user base is limited.
- Lack of infrastructure to advanced technology based banking services.
- The absence of a regulatory framework for Internet banking transactions in India.
- The mindset of the Indian consumer, who prefers personal interactions and is not very comfortable, doing transactions through the Internet.
- Limited awareness about the potential of Internet banking on the part of banks

Question :

Prepare a report on the basic concepts of Internet banking, its working mechanism and benefits.

17.5.11 Model Case study on Financial Inclusion – A Huge Challenge

The RBI in its second quarter review of the monetary policy 2012-13 has mandated the State Level Bankers' Committees (SLBCs) to prepare a roadmap for provision of banking services in all unbanked villages with less than 2,000 people in a time bound manner. "Moving towards universal financial inclusion has been a national commitment," the RBI has emphasized in its report. The Financial Inclusion Advisory Committee chaired by Dr K C Chakrabarty will explore viable, affordable and sustainable banking service delivery models for unbanked population and suggest appropriate regulatory framework to stabilise financial inclusion.

Over the years, banks have introduced many innovations: ATMs, kissan credit cards, general credit cards, freedom prepaid cards, biometric cards, phone banking, mobilebanking, electronic clearance services and banking correspondence to achieve financial inclusion.

Access to Credit

Over the last two decades India has witnessed the world's biggest micro credit movement in the world. As on March 31, 2012, nearly 86 lakh SHGs have been bank-linked. So nearly 17.20 crore people get access to banks' credit to start hundreds of small economic activities: Achar, masala, jelly, jam, papad, herbal medicines, handicrafts, handloom items and different kinds of eatables etc. The RBI has further asked banks to open zero balance savings bank account with ATM cum debit card facility so that all kinds of wages, subsidy and bank credit could be routed through bank accounts.

The Union government had allocated ` 50 crore in 2011-12 budget for banks to meet the expenditure towards opening zero balance accounts. As per the RBI report, banks have covered 74,199 unbanked villages by March 2012 out of the target of 74,414 villages. Now the RBI is out to cover all unbanked villages across the country. Both public and private sector banks have set self targets of opening rural brick and mortar branches to cover unbanked villages. The number of brick and mortar branches has increased from 21,475 in March 2010 to 1,11,948 by March 2012. The number of no frills accounts has increased to 99 million by March 2012.

Over the decades, 31 state cooperative banks with their 371 DCCBs and nearly one lakh cooperative society outlets have been recapitalised and rescued from bad financial state from time to time in order to meet the unbanked population. Besides, many micro finance institutions have rolled their money to reach the unbanked population in the last decade. In spite of a series of efforts, financial inclusion has not yielded the desired result because it is more a metabolic growth than a time bound programme which needs proper environment to take its root. In fact, the purpose of financial inclusion is to activate the micro credit cycle which ultimately helps borrowers to earn surplus after meeting their consumption need.

Banks, extension departments, people's representatives, NGOs and civil society have the joint responsibility to create credit absorption capacity among people. The rise in the price of sugar has made sugarcane replace pulses and other crops in Kolhapur district. Initially, the farmers got surplus income. But their joy turned in to frustration when the thirsty canes needed more water and the cost of inputs increased. The surplus eroded when farmers had to buy food grains at a higher cost from the market. Clay models made by the artisans of Cuttack have high demand in different studios and in puja pendals across the country. In the absence of marketing facilities, credit flow can only become a bad loan. In pilgrim centre of Puri, people have the indigenous skill to make mouth watering sweet items from milk and ghee. If those items are not marketed, bank credit will become a burden on the producers. Pure cow ghee has huge demand all over the world for its medicinal, nutritional and religious value. Today one can find tonnes of adulterated cow ghee packs even in big malls. Agro processed food items have suffered huge credibility loss because there is nobody to authenticate quality. Credibility loss always affects bulk of the business.

Unless the producers at the bottom of the pyramid are left with surplus they cannot help consumer driven economy. For instance, in 2005, the cost of a flat in a prime area in Pune was ` 2,000 per sq feet. In 2012, the cost rose to ` 12,000 per sq feet after 100 per cent FDI in realty sector was allowed. Consumers are left with little surplus after meeting the basic necessities of life. Aadhaar card based cash transfer may aggravate the agriculture labour shortage in the country

and make food costlier. There is need for scientific approach to address poverty through financial inclusion.

Questions
1. What innovations are done by banks over the past few years?
2. When will the bank credit become burden on the producers of several products?
3. How does loss of credibility affect the business?

17.6 SUMMARY

Case studies are real life business situations o hypothetical business scenarios to facilitate some elements of experiential learning. A business case study will present you with a business issue, a conflict to be resolved or an impending decision that needs to be made. In general, a case study should include, in order: background on the business environment, description of the given business, identification of a key problem or issue, steps taken to address the issue, your assessment of that response, and suggestions for better business strategy. Solving of cases with help these theories often become difficult we have to track our own ways. There is no ideal path to solve the realistic problems but looking forward I traced new way to solve it. It may not be ultimate option to solve your case but guide you in right direction where do you have to be. Some of the famous examples of case studies are John Martin Marlow's case study on Phineas Gage and Sigmund Freud's case studies, Little Hans and The Right Man. Case studies are widely used in psychology to provide insight into unusual conditions. In the present Unit we discussed various case studies on Banking and financial Institutions.

17.7 Key Words

Case study : A case study analysis require you to investigate an organizational challenge, provide solution based on a tried theoretical framework or model and then propose the most effective solution/s using evidence based research.

SWOT Analysis : SWOT analysis to get a better understanding of the company's strengths and weaknesses. A SWOT analysis involves documenting things like internal strengths (S) and weaknesses (W) and external opportunities (O) and threats (T).
T
ypes of Case studies: Depending on the industry, the types of case studies may be classified a Descriptive, Explanatory, Exploratory, Intrinsic, Instrumental and Collective case studies.

17.8 SELF ASSESSMENT QUESTIONS

Essay Typed Questions

1. Write an essay on How to prepare a case ?
2. Explain the process of drafting a case
3. How do you finalize the case?

Short Answer Questions

1. What do you mean by case
2. Steps in preparing a case

17.9 SUGGESTED READINGS

1. Sandeep Panchpande, "Indian Business Case Studiess", Oxford,2022
2. Robert F. Bruner (Author), Kenneth Eades (Author), Michael Schill (Author), "Case studies in Banking", McGraw-Hill Higher Education, 2009
3. https://www.linkedin.com/pulse/20-famous-case-studies-every-mba-student-ought-know-dare2compete
4. https://www.gsb.stanford.edu/faculty-research/case-studies
5. https://unstop.com/blog/20-famous-case-studies-that-every-mba-student-ought-to-know
6. https://hbsp.harvard.edu/cases/
7. https://som.yale.edu/story/2023/top-40-case-studies-2022-23

Dr. P. Venu Gopal