BANKING & INSURANCE OPERATIONS

MBA 927

Ques. 1 What is Bank and its features?

Bank is an institution which deals with money and credit. It accepts deposits from the public, makes the funds available to those who need them, and helps in the remittance of money from one place to another.

Features

***(i)* Dealing in money:**

The banks accept deposits from the public and advancing them as loans to the needy people. The deposits may be of different types current, fixed, savings, etc. accounts. The deposits are accepted on various terms and conditions.

***(ii)* Deposits must be withdrawn able:**

The deposits (other than fixed deposits) made by the public can be withdraw able by cheques, draft or otherwise, i.e., the bank issue and pay cheques. The deposits are usually withdrawn able on demand.

***(iii)* Dealing with credit:**

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

***(iv)* Commercial in nature:**

Since all the banking functions are carried on with the aim of making profit, it is regarded as a commercial institution.

***(v)* Nature of agent:**

Besides the basic functions of accepting deposits and lending money as loans, banks possess the character of an agent because of its various agency services.

Ques. 2 Explain the role of Reserve Bank of India

RBI-Reserve Bank of India RBI was established on 1 April 1935 with the sole aim to work as banking sector regulator .RBI was nationalized in 1949.RBI regulate the banking sector (government and private banks) by banking regulation act 1949 and RBI act 1935 which entrusted responsibility on the RBI to work for the enhancement of banking sector in India .RBI is the sole authority to issue banking licenses to entities who want to open bank in India , and if any bank want to open new branch it has to be take prior approval from RBI. The main aim of RBI is to provide banking services to the last mile of country .To full this initiative RBI has started financial inclusion program .In this RBI mandated all banks in India to open at least 25 percent braches in rural areas. RBI also ensure that adequate credit is provide to rural areas by priority sector lending In this RBI has mandated all banks including foreign banks working in India to provide 40 percent of their loans to priority sector like agriculture, student loans etc .If any bank found violating RBI policy ,it has power to take action against it . RBI do supervision functions and regular checks to ensure that financial health of banks is maintained .RBI ensure that all banks follow the government guidelines for the banking sector. If any bank found indulging in activities against people interest and violating government polices RBI can fine bank including private banks.

Major functions of the RBI are as follows:

1. Issue of Bank Notes:

The Reserve Bank of India has the sole right to issue currency notes except one rupee notes which are issued by the Ministry of Finance. Currency notes issued by the Reserve Bank are declared unlimited legal tender throughout the country. This concentration of notes issue function with the Reserve Bank has a number of advantages: (i) it brings uniformity in notes issue; (ii) it makes possible effective state supervision; (iii) it is easier to control and regulate

credit in accordance with the requirements in the economy; and (iv) it keeps faith of the public in the paper currency.

2. Banker to Government:

As banker to the government the Reserve Bank manages the banking needs of the government. It has to-maintain and operate the government's deposit accounts. It collects receipts of funds and makes payments on behalf of the government. It represents the Government of India as the member of the IMF and the World Bank.

3. Custodian of Cash Reserves of Commercial Banks:

The commercial banks hold deposits in the Reserve Bank and the latter has the custody of the cash reserves of the commercial banks.

4. Custodian of Country's Foreign Currency Reserves:

The Reserve Bank has the custody of the country's reserves of international currency, and this enables the Reserve Bank to deal with crisis connected with adverse balance of payments position.

5. Lender of Last Resort:

The commercial banks approach the Reserve Bank in times of emergency to tide over financial difficulties, and the Reserve bank comes to their rescue though it might charge a higher rate of interest.

6. Central Clearance and Accounts Settlement:

Since commercial banks have their surplus cash reserves deposited in the Reserve Bank, it is easier to deal with each other and settle the claim of each on the other through book keeping entries in the books of the Reserve Bank. The clearing of accounts has now become an essential function of the Reserve Bank.

7. Controller of Credit:

Since credit money forms the most important part of supply of money, and since the supply of money has important implications for economic stability, the importance of control of credit

becomes obvious. Credit is controlled by the Reserve Bank in accordance with the economic priorities of the government.

Ques. 3 Explain about various Payments Systems in Banks In India

In a series of providing useful material for Banking Awareness section of various banking exams. Today I am explaining various payment systems available in banks in a very simple language.

1. **RTGS: Real Time Gross Settlement** It is a centralized payment system through which inter bank payment• A 'service charge' is charged by the banks for outwards transactions (making• Minimum amount is Rs. 2 lacs and there is no limit to maximum amount. • Which simply means, that the transactions are settled as they happen. •instructions are processed and settled, on GROSS basis, in REAL TIME. an RTGS) and nil for inwards transactions (receiving an RTGS). RTGS is used by banks to settle their inter-bank account transactions as well It uses INFINET (Indian Financial Network) platform to operate.•as customer's high value transactions.

2. **NEFT: National Electronic Funds Transfer** It is a nation-wide funds transfer system which facilitates fund transfer from• The difference between NEFT and RTGS is that NEFT settlements happen in•any bank's branch to any other bank's branch. batches, and on net settlement basis. Where as RTGS is real time and gross Net Settlement means, that transaction pertaining to a particular bank branches•settlement. are kept on hold and accumulated and then processed together in a batch with NEFT cannot be used for foreign remittances.• There is no limit to minimum/maximum transaction value. •the 'net' amount, which would either be incoming or outgoing transfer.

3. **AEPS: AADHAR Enabled Payment System** It is a payment system which uses Aadhar card number and an individuals• A customer will have to register his/her Aadhar number to their existing bank•online UIDAI authentication, which are linked to a customers Bank

account. Through AEPS, customer can withdraw or deposit cash, make balance•account, provided their bank is AEPS enabled. These transactions are normally conducted by Business Correspondents (BCs)• The maximum amount of transaction per account per day is Rs.50,000. •enquiry, and transfer funds. service centers.

4. **MTSS: Money Transfer Service Scheme** It is a system of money transfer for transferring personal remittances from• Through this only inward remittances into India are permissible. No outward•abroad to beneficiaries in India. A maximum of Rs.50,000 can be remitted inwards as per the money value.•remittance allowed. And a maximum of 30 transactions per calendar year.

5. **Nepal Remittance Scheme:** It is a cross-border one-way remittance facility scheme for remittance from• Maximum amount remittance is INR 50,000 and beneficiaries will receive in•India to Nepal. Nepalese Rupees.

Ques. 4 Explain the differences between a Central Bank and Commercial Bank

Central Bank:

- Work for the public welfare and economic development of a country. A central bank is governed by the government of a country.
- Controls and regulates the entries banking system of a country.
- Does not deal directly with the public. It issue guidelines to commercial banks for the economical development of the country.
- Issues currency and control the supply of money in the Market.
- Acts as a state owned institution.
- Act as a custodian of a foreign exchange of the country.

- Act as a banker to the Government.
- Controls credit creations in the economy, thus acts as a clearing house of other banks.

Commercial Bank:

- Operates for Profit Motive. The Majority of Stake is held by the government as well as the private sector.
- Operates under the direct control and supervision of the central bank. In India all the commercial banks works under the guidelines issued by RBI.
- Deals directly with the Public. It serves the financial requirement of the public by providing short and medium terms loans and depositing and securing money that can be drawn on demand.
- Does not Issue currency, but only adds to the approval of the central bank.
- Acts as a state or private owned institution.
- Perform foreign exchange business only on the approval of the central bank.
- Acts as agents of the central bank.
- Acts as a clearing house only as a agent of the central bank.

Ques. 5 Explain the types of Various Bank Accounts and procedure to opening an account in a bank.

Demand Deposits: it refers to deposits received by banker, repayable on demand i.e. customers withdraw when they want.

Following can be demand deposits:

- Savings Bank Account
- Current Account

Term Deposits: Deposit accepted by Bank which is repayable only after a fixed period of time.

- Fixed Deposit Account
- Recurring Deposit Account

Process of account opening

- Application in a prescribed form
- Identification of the customer
- Photograph of account holder
- Specimen signatures
- Address of account holder
- Opening of account
- Issue of cheque book
- Issue of pass book
- Issue of pay in slip and withdrawal forms
- Nomination

Ques. 6 Write a detailed note on types of customers.

Banks open accounts for various types of customers like individuals, partnership firm, Trusts, companies, etc. While opening the accounts, the banker has to keep in mind the various legal aspects involved in opening and conducting those accounts, as also the practices followed in conducting those accounts. Normally, the banks have to deal with following types of deposit customers.

1. Individuals
2. Joint Hindu Families
3. Partnership Firms
4. Limited Liability Companies
5. Clubs and Associations
6. Trusts

1. **Individuals**

The depositor should be properly introduced to the bank and KYC norms are to be observed. Introduction is necessary in terms of banking practice and also for the purpose of protection under section 131 of the Negotiable Instruments Act. Usually, banks accept introductions from the existing customers, employee of the bank, a locally well-known person or another bank.

A joint account may be opened by two or more persons and the account opening form etc., should be signed by all the joint account holders. When a joint account is opened in the name of two persons, the account operations may done by

a. Either or survivor
b. Both jointly
c. Both jointly or by the survivor
d. Former or survivor

When the Joint account is in the names of more than two person, then the following operations are made:

a. all of them jointly or by survivors
b. any one of them or by more than one of them jointly

Non-resident individuals (NRIs)

Non-Resident Indian means, a person, being a citizen of India or a person of Indian origin residing outside India. A person is considered Indian Origin when he or his parents or any of his grand parents were Indian National. If at any time held an Indian passport, (nationals of Bangladesh and Pakistan are not deemed to be of Indian origin), a spouse (who is not a Bangladeshi or Pakistan national), of a person of Indian origin shall also be deemed to be of Indian origin. Non-resident falls generally into the following two categories:

a. A person who stay abroad for the purpose of employment or to carry on business activities or vocation or for any other purpose for an indefinite period of stay outside India and
b. Indian National working abroad for a specific period.

Facilities for maintaining bank accounts are available in India to Indian National or origin, living abroad. The exchange control procedures relating to these facilities have been simplified. The details of various deposit schemes available to NRI's are as follows:

Various Types of NRI Accounts

- Ordinary Non-resident Rupee Accounts (NRO Accounts);
- Non-Resident (External) Rupee Accounts (NRE Accounts);
- Non-resident (Non-Repatriable) Rupee Deposits (NRNR Accounts); and
- Foreign Currency (Non-Resident) Accounts (Banks) Scheme (FCNR (B) Accounts).

While NRO and NRE accounts can be kept in the form of current, savings bank, recurring deposit or term deposit accounts, deposits under NRNR and FCNR (B) schemes can be kept only in the form of term deposits for periods ranging from six months to three years.

2. Joint Hindu Family (JHF):

Joint Hindu Family (JHF) (also known as Hindu Undivided family) is a legal entity and is unique for Hindus. It has perpetual succession like companies; but it does not require any registration. The head of JHF is the Karta and members of the family are called co-parceners. The JHF business is managed by Karta.

3. Partnership firms

A partnership is not a legal entity independent of partners. It is an association of persons. Registration of a partnership is not compulsory under Partnership Act. However, many banks insist on registration of a partnership. In any case, ie stamped partnership deed or Partnership letter should be taken when an account is opened for a partnership. The partnership deed will contain names of the partners, objective of the partnership, and other operational details, which should be taken note of by the bank in its dealings.

4. Joint stock companies (Limited Liability Companies)

A company is registered under companies Act has a legal status independent of that of the share-holders. A company is an artificial person which has perpetual existence with limited liability and common seal. Memorandum and Articles of Association, Certificate of Incorporation, Resolution passed by the Board to open account, name and designations of persons who will operate the account with details of restriction placed on them are the essentials documents

required
to open an account.

5. Clubs, Societies and Associations

The clubs, societies, association etc., may be unregistered or registered. Account may be opened only if persons of high standing and reliability are in the managing committee or governing body. Copy of certificate of registration and Copy of bye-law, certified to be the latest, by the Secretary/President are required to be obtained and also a certified copy of the resolution of the Managing Committee/Governing body to open the bank account and giving details of office bearers etc., to operate the account.

6. Trust Account:

Trusts are created by the settler by executing a Trust Deed. A trust account can be opened only after obtaining and scrutinizing the trust deed. The Trust account has to be operated by all the trustees jointly unless provided otherwise in the trust deed. A trustee cannot delegate the powers to other Trustees except as provided for in the Trust Deed. A cheque favoring the Trust shall not be credited to the personal account of the Trustee.

Ques. 7 What is KYC? Why is it required? What are the KYC requirements for opening a bank account? What are the documents to be given as 'proof of identity' and 'proof of address'?

KYC means "Know Your Customer". It is a process by which banks obtain information about the identity and address of the customers. This process helps to ensure that banks' services are not misused. The KYC procedure is to be completed by the banks while opening accounts. Banks are also required to periodically update their customers' KYC details.

To open a bank account, one needs to submit a 'proof of identity and proof of address' together with a recent photograph.

The Government of India has notified six documents as 'Officially Valid Documents' (OVDs) for the purpose of producing proof of identity. These six documents are Passport, Driving

Licence, Voters' Identity Card, PAN Card, Aadhaar Card issued by UIDAI and NREGA Job Card. You need to submit any one of these documents as proof of identity. If these documents also contain your address details, then it would also be accepted as 'proof of address'. If the document submitted by you for proof of identity does not contain address details, then you will have to submit another officially valid document which contains address details.

As per RBI guidelines issued vide their circular dated 29/11/2004, all banks are required to formulate a KYC Policy with the approval of their respective boards. The KYC Policy consists of the following four key elements.

1. Customer Acceptance Policy
2. Customer Identification Procedures
3. Monitoring of Transactions
4. Risk Management.

KYC will be carried out for the following but is not limited to:

- Opening a new account.(deposit/lending)
- Opening a subsequent account where documents as per current KYC standards not submitted while opening the initial account.
- When the bank feels it is necessary to obtain additional information from existing customers based on the conduct of the account.
- After periodic intervals based on instructions received from RBI.

When there are changes to signatories, mandate holders, beneficial owners, etc.

Objectives of KYC

- To be aware of the identity of the customer
- To be aware of the location of the customer
- To prevent banks being used, intentionally or unintentionally by criminals or terrorist elements.

Ques. 8 write a note on credit cards.

A credit card is a card issued by a financial company giving the holder an option to borrow funds, usually at point of sale. Credit cards charge interest and are primarily used for short-term financing. Interest usually begins one month after a purchase is made, and borrowing limits are pre-set according to the individual's credit rating.

The credit card is a document of cardholder's credit worthiness on the one hand which minimizes the use of hard cash in the day to day transactions.

a. It is a convenient medium of exchange which enables its holder to buy goods and services without using money.
b. No matter where the cardholder is, he does not have to worry about to carry enough money for his purchases.
c. Credit card helps its holder to buy when he wants and to pay when he can.
d. Credit cards are issued to people having a certain minimum income.
e. The cardholder is required to pay neither an interest nor a higher price for the goods purchased.
f. The bank also bears the risk of default on the part of cardholder.
g. The net gain of the bank is the amount of commission from the seller minus interest factors and advertisement and administrative costs.
h. The credit cards are mostly used by elite corporate executives, businessmen, middle income groups, etc.
i. Credit limit is specified for every credit card. They can either buy goods or draw cash up the limit.

Ques. 9. What is the Organization Structure & Management

- **Section-7 of the RBI deals with the management of the banks.**
- Organisation Structure of the Bank consists of:
- **1. Central Board:** The board includes **20 members**, engaged in superintendence and general directions of Bank affairs.

- **A governor** who is the Chief Executive Head and **four Deputy Governors** to be appointed by the Central Government for a period of 5 years;
- **Four Directors** to be nominated by the Central Government, one from each of the four local Boards;
- **Ten directors** nominated by the Central Government to represent various economic interests of the country; and
- **One Government official** from the Ministry of Finance.
- The Central office is situated at Mumbai.

- Local Boards: There are four local boards with headquarters at Mumbai, New Delhi, Kolkata and Chennai. Each Regional Board consists of 5 members appointed by the Central Government for a period of 4 years. The functions of the local boards are to advise the Central Board on general issues related with banks or any other matters.

Ques. 10 What are Regional Rural Banks and its features?

- In 1975, Mrs. Indra Gandhi (former PM of India), announced 20-point economic programme. One point in the programme was related with the rural indebtedness. In was felt that a new breed of banks should be started to meet the consumption and production needs of weaker sections in rural areas-small and marginal farmers, rural artisans, agriculture labourers, SC and STs.
- The Govt. appointed a working group under the Chairmanship of Shri M. Narasimham to study the issue. The group recommended the establishment of RRBs on July 30, 1975. The first 5 RRBs were set up on October 2, 1975. Later the number increased to 196.

Features of RRBs.

- To provide credit facilities to agriculture sector with special emphasis on small and marginal farmers and agricultural labourers.
- To provide the welfare economically and society backward sections like STs and SCs and backward classes.
- To mobilize deposits from rural people.
- To render agency and general utility services like commercial banks.

Ques. 11. Explain the banker & customer relationship.

- BANKER:- A banker is one who performs the business of banking. The term banking has already been defined earlier.
- A banking company must perform both of the essential functions:

  (a) Accepting of deposits,

  (b) Lending or Investing the same.

  If the purpose of accepting of deposits is not to lend or invest, the business will not be called banking business.

- The banker accepts deposits of money and not of anything else. The word public implies that banker accept deposits from anyone who is capable of contracting and who offers his/her money for such purpose.
- The definition also specifies the time and mode of withdrawal of deposits. The depositor must make a demand for withdrawing his/her money. The demand should be made in a proper manner and through an instrument in writing and not merely by verbal order or a telephonic message.
- Customer:- Customer is a person who opens a deposit or current account or negotiates an advance on current or loan account. Accordingly, person who goes to encash a bearer cheque in the bank, or visits a bank to deposit applications money for allotment of shares of a company shall not be termed as a customer.
- Relationship as Debtor and Creditor:-When a customer opens an account with a bank and if the account has a credit balance, then the relationship is that of debtor (banker / bank) and creditor (customer).
- In case of savings / fixed deposit / current account (with credit balance), the banker is the debtor, and the customer is the creditor. This is because the banker owes money to the customer. The customer has the right to demand back his money whenever he wants it from the banker, and the banker must repay the balance to the customer.

- In case of loan / advance accounts, banker is the creditor, and the customer is the debtor because the customer owes money to the banker. The banker can demand the repayment of loan / advance on the due date, and the customer has to repay the debt.

  The relationship between customer and banker can be that of Pledger and Pledgee. This happens when customer pledges (promises) certain assets or security with the bank in order to get a loan. In this case, the customer becomes the Pledger, and the bank becomes the Pledgee. Under this agreement, the assets or security will remain with the bank until a customer repays the loan.

- Banker as an Agent:- A banker acts as an agent of his customer in many ways, e.g., when he buys or sells securities or makes payment of various dues of his customers, or collects cheques on his behalf. In all these cases, the banker acts as an agent of his customer.

  Lessor and Lessee (Bank as Lessor and Customer as Lessee)

- The bank provides safe deposit lockers to the customers who hire them on lease basis. The relationship therefore, is that of lessor and lessee. The bank is not responsible for any loss that arises to the lessee in this form of transaction except due to negligence of that bank.

  Indemnifier (customer) and Indemnity holder (Bank)

- A contract by which one party promises to save the other from loss caused to him by the conduct of the promisor himself or the conduct of any other person is called a contract of indemnity.
- It can be happens in transactions of issue of duplicate DD, FD receipt etc.

Ques. 12 Explain the nomination rules and death claim and settlement of bank accounts?

- Banking Companies (Nomination) Rules 1985 permits banks to pay dues to nominees in the event of death of depositor(s) without asking for succession certificate or verifying

claims of legal beneficiary. This simplifies settlement. Of course, as Trustee the nominee is accountable to legal beneficiary.

- Nomination facility available for bank deposits, safe deposit lockers, safe custody articles.
- There can be only one Nominee for a deposit account whether held singly or jointly.
- There can be two nominees for a jointly held locker.
- A person legally empowered to operate a minor's account can file a nomination on behalf of the minor.

Simplified Procedure for individuals

I. **CLAIM IN ACCOUNT OF A DECEASED ACCOUNTHOLDER WILL BE SETTLED IN**

THE FOLLOWING ORDER:

1. Payment to Nominee – If there is valid nomination, payment will be made to the nominee after proper identification.

If valid nomination is not available – then

2. a. Payment to legal beneficiary on production of legal representation of will, if the deceased has left behind a will.

If there is no legal representation of will – then

b. Payment to legal beneficiary based on indemnity – if all the legal beneficiaries join together

(if they are not joining together or if there is any dispute, they have to get a court

order)

II. DOCUMENTS REQUIRED:

As a matter of general rule following documents are required in all cases of death claim in accounts where no nomination is given by the customer/s:

i. Death Certificate.

ii. Death claim form (Estate claim form) duly filled in by the legal heirs/claimants.

iii A declaration/undertaking in prescribed format (To be stamped as an agreement)

Ques. 13 What is Banking Technology ?

E-Banking (Electronic banking) means the use of technology which allows customers to perform banking transactions electronically without visiting the Bank branch. Online means direct linking of an operation or equipment to a computer system. For banks it is a cost effective mean for global expansion.

- E-banking include electronic funds transfer, electronic clearing service and electronic payment or transfer media including the credit card, debit card and smart card. Online banking helps consumers to overcome the limitations of place and time as they can bank anywhere, anytime as these services are available 24 hours, 365 days a year without any physical limitations of space like a specific bank branch, city or region.
- Internet Banking is the ability to use one's personal computer to communicate with one's bank. Internet Banking and online Banking is an outgrowth of PC banking. PC banking enables customers to execute bank transactions from their personal computer via modem through a financial software of the bank. All banks, which propose to offer internet banking services, should obtain prior approval from RBI.
- A number of routine issues which are simple in nature but time consuming can be handled through the internet, Opening account, balance enquiries, FD renewals, request for cheque books, foreign exchange rates, online bill payment request, stop payment request, request for debit cards, online funds transfer and monthly statement by email.
- A system whereby a person at home or in an office can use a computer with a modem to call up information from a bank or to transfer funds electronically.

Home Banking

- The practice of conducting banking transactions from home rather than at branch locations. Home banking generally refers to either banking over the telephone or on the internet. The first experiments with internet banking started in the early 1980s, but it did not become popular until the mid 1990s.
- **Mobile banking**
- **It** is a system that allows customers of a financial institution to conduct a number of financial transactions through a mobile device such as a mobile phone.
- Mobile banking differs from mobile payments, which involve the use of a mobile device to pay for goods or services.
- The earliest mobile banking services were offered over SMS, a service known as SMS banking. With the introduction of smart phones with WAP (wireless application protocol) support enabling the use of the mobile web in 1999, the first European banks started to offer mobile banking on this platform to their customers.

Ques. 14 What is ATM and its features and operations?

An ATM is a computerized telecommunications device that provides a financial institution's customers a secure method of performing financial transactions in a public place without the help of bank staff (clerk).

Automated Teller Machine (ATM)

- An earlier version of an ATM was developed in 1939 in New York, by the City Bank of New York, But removed only after 6 months of installation due to the lack of customer acceptance. After 25 years (approx.) Barclays bank of UK installed an ATM in 1967 in London.
- ATMs can be interior (located in the brach premises) or exterior (located outside the branch premises, e.g., at railway stations, airports, shopping malls, colleges, Hospitals, Hotels, restaurants, markets. Banks need not obtain permission of the RBI for the installation of ATMs at branches or outside areas.

Operation of ATM

- For using an ATM, a customer requires an ATM card. It is made of plastic with a magnetic stripe or a plastic smart card with a chip. Customer has a special card number that is referred to as a PIN (personal identification number). The customer has to insert the card in the machine and quote his/her PIN. Upon successfully entry of the PIN, the customer may perform a transaction. After the completion of the transaction, a transaction record is printed, usually stating the action taken, date, time, location, available balance.

Debit Card/ATM Card

- A Debit card is an ATM card. It is payment mechanism which allows the holder to make purchases without making any immediate cash payment. It appears that plastic money seems to be the preferred mode of payment for more and more people. A customer can take withdrawals from his/her bank account with the help of this debit or ATM card.

Ques. 15 What is Core (centralized online real-time electronic) Banking Solutions? Also explain its services.

Core banking solution is a system that enables banks to interconnect all their branches which then enable customers to operate accounts and avail banking services from any branch of the bank in the country, regardless where he maintains his account. The customer need not to operate only though his home branch but can go to the nearest branch for banking services.

Services:

- Enquiries about debit/credit entries
- Obtain cash payment by cheque
- Deposit a cheque for credit
- Deposit cheque/cash into account of an another person
- To obtain demand draft facility

Ques. 16. Explain the types of Lending and modes of creating charges.

- The main function of the bank is to accept deposits and provide loans, the major portion of the funds are used for the lending and this is the major source of income (interest) for the bank. A loan is granted for the specific period of time. - Time period for the loans may be short or may be for the long. The borrower have to repay the loan as lump sum amount or in installments.

Types of Loans

On the basis of time

- Short term loan: < one year
- Medium term loan: 1 year to 3 years
- Long term loan: 3 years to 20 years
- **On the basis of security**

Secured Loan: such loan is granted on the security of tangible assets.

Unsecured Loan: such loan is granted without any security.

- **On the basis of form**

Loan: it is a kind of advance made with or without any security (collateral). It is given for a fixed period at an agreed rate of interest.

Cash Credit: a facility where bank allows the borrower to withdraw cash from time to time for the short period of time with specific limit.

Overdraft: a facility where bank allows the customers to overdraw from its current deposit account within a specific limit.

- Loans
- Cash Credit
- Overdraft
- Discounting of Bills of Exchange

- Financing book debts (Trade Debtors)

Short Notes

Ques. 17 Explain Repo Rate and Reverse Rate

When we need money, we take loans from banks. And banks charge certain interest rate on these loans. This is called as cost of credit (the rate at which we borrow the money). Similarly, when banks need money they approach RBI. The rate at which banks borrow money from the RBI by selling their surplus government securities to RBI is known as "Repo Rate." Repo rate is short form of Repurchase Rate. Generally, these loans are for short durations up to 2 weeks. It simply means Repo Rate is the rate at which RBI lends money to commercial banks against the pledge of government securities whenever the banks are in need of funds to meet their day-to-day obligations. Banks enter into an agreement with the RBI to repurchase the same pledged government securities at a future date at a pre-determined price. RBI manages this repo rate which is the cost of credit for the bank. Example - *If repo rate is 5% , and bank takes loan of Rs 1000 from RBI , they will pay interest of Rs 50 to RBI.* So, higher the repo rate higher the cost of short-term money and vice versa.

Higher repo rate may slowdown the growth of the economy. If the repo rate is low then banks can charge lower interest rates on the loans taken by us. So whenever the repo rate is cut, can we expect both the deposit rates and lending rates of banks to come down to some extent? This may or may not happen every time. The lending rate of banks goes down to the existing bank borrowers only when the banks reduce their base rates (Base Rate is the minimum rate below which Banks are not permitted to lend) as all lending rates of banks are linked to the base rate of every bank. In the absence of a cut in the base rate, the repo rate cut does not get automatically transmitted to the individual bank customers. This is the reason why you might have observed that your loan EMIsremain same even after RBI lowers the repo rates. Banks check various other factors (like credit to deposit ratios etc.,) before reducing the Base rates.

Reverse Repo Rate

Reverse repo rate is the rate of interest offered by RBI, when banks deposit their surplus funds with the RBI for short periods. When banks have surplus funds but have no lending (or) investment options, they deposit such funds with RBI. Banks earn interest on such funds.

Current CRR, SLR, Repo and Reverse Repo Rates: The current rates are (as of last week of December 2015) - CRR is 4 % , SLR is 21.50%, Repo Rate is 8% and Reverse Repo Rate is 7%.

Reverse repo rate is the rate of interest offered by RBI, when banks deposit their surplus funds with the RBI for short periods. When banks have surplus funds but have no lending (or) investment options, they deposit such funds with RBI. Banks earn interest on such funds.

Current CRR, SLR, Repo and Reverse Repo Rates: The current rates are (as of last week of December 2015) - CRR is 4 % , SLR is 21.50%, Repo Rate is 8% and Reverse Repo Rate is 7%.

Ques.18 What is Statutory Liquidity Ratio (SLR)?

Besides CRR, Banks have to invest certain percentage of their deposits in specified financial securities like Central Government or State Government securities. This percentage is known as SLR. This money is predominantly invested in government approved securities (bonds), Gold, which mean the banks can earn some amount as 'interest' on these investments as against CRR where they do not earn anything. Example - *An Individual deposits say Rs 1000 in bank. Then Bank receives Rs 1000 and has to keep some percentage of it with RBI as SLR. If the prevailing SLR is 20% then they will have to invest Rs 200 in Government Securities*

Ques. 19 What is Bank Rate?

A bank rate is the interest rate at which a nation's central bank lends money to domestic banks, often in the form of very short-term loans. Managing the bank rate is method by which central banks affect economic activity. Lower bank rates can help to expand the economy by lowering the cost of funds for borrowers, and higher bank rates help to reign in the economy when inflation is higher than desired.

Ques. 20 What is Capital Adequacy Ratio?

The capital adequacy ratio (CAR) is a measure of a bank's capital. It is expressed as a percentage of a bank's risk weighted credit exposures.

Also known as capital-to-risk weighted assets ratio (CRAR), it is used to protect depositors and promote the stability and efficiency of financial systems around the world. Two types of capital are measured: tier one capital, which can absorb losses without a bank being required to cease trading, and tier two capital, which can absorb losses in the event of a winding-up and so provides a lesser degree of protection to depositors.

$$CAR = \frac{\text{Tier One Capital} + \text{Tier Two Capital}}{\text{Risk Weighted Assets}}$$

Ques. 21 What is Reinsurance?

It occurs when multiple insurance companies share risk by purchasing insurance policies from other insurers to limit the total loss the original insurer would experience in case of disaster. By spreading risk, an individual insurance company can take on clients whose coverage would be too great of a burden for the single insurance company to handle alone. When reinsurance occurs, the premium paid by the insured is typically shared by all of the insurance companies involved.

Risk Transfer - Companies can share or transfer of specific risks with other companies

1. Arbitrage - Additional profits can be garnered by purchasing insurance elsewhere for less than the premium the company collects from policyholders.
2. Capital Management - Companies can avoid having to absorb large losses by passing risk; this frees up additional capital.
3. Solvency Margins - The purchase of surplus relief insurance allows companies to accept new clients and avoid the need to raise additional capital.

Expertise - The expertise of another insurer can help a company obtain a proper rating and premium

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