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PRINCIPLES OF BANKING

JV'n Prof. (Dr.) Sanjay Chhabra

JAYOTI VIDYAPEETH WOMEN'S UNIVERSITY, JAIPUR

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''बेटी बचाओ, बेटी पढ़ाओ''

DR. SANJAY CHHABRA
PROFESSOR
FACULTY OF LAW & GOVERNANCE
JAYOTI VIDYAPEETH WOMEN'S UNIVERSITY

JAIPUR ; RAJASTHAN

CONTENTS

PRINCIPLES OF BANKING

UNIT I

- Indian Banking System: Evaluation of Banking Institutions; Banking System of India;
- Different Banking Institutions in India, their role and functions;
- Regulatory framework of Banking in India;
- Functions of Commercial Banks; Sound Commercial Banking principles.

Evolution of Indian Banks

• **Banking in India** originated in the last decades of the 18th century.

• The first bank was The General Bank of India, which started in 1786.

• Bank of Hindustan was the 2nd bank, which started in 1790; both are now defunct.

• The oldest bank in existence in India is the State Bank of India, which originated in the Bank of Calcutta in June 1806, which almost immediately became the Bank of Bengal.

• The period between 1906 and 1911, saw the establishment of banks inspired by the Swadeshi movement. A number of banks established then have survived to the present such as Bank of India, Corporation Bank, Indian Bank, Bank of Baroda, Canara Bank and Central Bank of India.

• During the First World War (1914–1918) through the end of the Second World War (1939–1945), and two years thereafter until the independence of India were challenging for Indian banking.

From Bank of Hindustan in 1770, the evolution of banking in India can be divided into three different periods as follows:

Phase I: Early phase of primitive Indian banks to Nationalization of Banks in 1969

Phase II: From Nationalization of India banks in 1969 up to advent of liberalization and banking reforms in 1991

Phase III: From Indian Financial and Banking Sector Reforms 1991 onward

Post Independence

• India observed the emergence of large number of institutions for providing finance to different sectors of the economy.

• The entry activities of private sector and foreign banks were restricted through branch licensing and regulation norms.

• Steps taken by Indian Govt. to regulate banking are:

Reserve bank of India was nationalized on January 1, 1949 under the terms of Reserve bank of India.

• In 1949, the Banking Regulation Act was in acted.

• The Banking Regulation Act also provided that no new bank or branch of an existing bank could be opened without a license from the RBI.

• No two banks could have common directors.

Nationalization

• The nationalization of banks in India took place in 1969 by Mrs. Indira Gandhi. It nationalized 14 banks. Before the steps of nationalization of Indian banks, only State Bank of India (SBI) was nationalized.

• Nationalization of Seven State Banks of India (formed subsidiary) took place on 19th July, 1960.

• The second phase of nationalization of Indian banks took place in the year 1980. Seven more banks were nationalized with deposits over 200 crores.

• The stated reason for the nationalization was to give the government more control of credit delivery.

Adoption of banking technology

The IT revolution had a great impact in the Indian banking system:

• Introduction of online banking in India.

• Formation of committee on Mechanization in the banking Industry in 1984, providing use of standardized cheque forms and encoders.

• Formation of committee on Computerization in Banks (1988) which emphasized that settlement operation must be computerized in the clearing houses of RBI.

• Focused on computerization of branches and increasing connectivity among branches through computers.

• Formation of Committee on Technology Issues relating to Payments System, Cheque Clearing and Securities Settlement in the Banking Industry (1994) emphasized on Electronic Funds Transfer (EFT) system, with the BANKNET communications network as its carrier.
• ATMs installed in India by various banks as on end March 2005 is 17,642.

Types of Banks

1. **The public sector banks** are owned and operated by the government, who has a major share in them. The major focus of these banks is to serve the people rather earn profits. Some examples of these banks include State Bank of India, Punjab National Bank, Bank of Maharashtra, etc.
2. **The regional rural banks** were brought into operation with the objective of providing credit to the rural and agricultural regions and were brought into effect in 1975 by RRB Act. These banks are restricted to operate only in the areas specified by government of India. These banks are owned by State Government and a sponsor bank. This sponsorship was to be done by a nationalized bank and a State Cooperative bank. Prathama Bank is one such example, which is located in Moradabad in U.P.
3. **The private sector banks** are owned and operated by private institutes. They are free to operate and are controlled by market forces. A greater share is held by private players and not the government. For example, Axis Bank, Kotak Mahindra Bank etc.

Performance of public sector bank

The financial system of any country consists of financial institutions, financial markets, financial instruments, financial services and financial assets. An efficient and a smooth financial system plays an important role in the nation's economic development. A well developed country will have a well-organized financial Institutions. Financial Institutions are an important part of the Indian Financial System. The institutions are divided into two categories, banking and non-banking. Banks play a pivotal role in India's economy. The year 1969 was a landmark in the history of commercial banking in India. In July 1969, the government nationalized 14 major commercial banks of the country. In 1980, 6 more banks were nationalized.
The first Five Year Plan held in the 1951 accorded the development of the rural areas as the highest priority. The plan was for the time period between 1951–1956. The All India Rural Credit Survey Committee advised the government to create state partnered and state owned banks. An act was passed in the par liament in May 1955 and the State Bank

of India was constituted. Later the State Bank of India Act was passed in 1959 to take over the associate banks of SBI and its subsidiaries. The pre-nationalization period saw a lion's share in the industrial sector to the bank's credit. Large scale industries cornered a large portion of the credit and the share of small scale industries was marginal. There were many reasons for the dominance of the large scale industries in the banking sector. Many commercial banks we re under the ownership and control of big industrial houses. A disturbing feature of the pre - nationalization banking policy was the negligence of agriculture sector to the bank's credit. This share hovered around 2% of the total commercial bank credit. The privately owned commercial banks were neither interested nor geared up to meet the risky and small credit requirements of the farmers. Similarly, the share of other non-industrial sectors was also very low. Since the commercial banks were under the control of big industrialists, the loanable funds of the banks were sometimes used to finance socially undesirable activities like hoarding of essential commodities.

The post-nationalization period witnessed certain drastic changes in the economy. All the leading commercial banks of the country were nationalized in the year 1969 with some objectives in mind. The objectives of nationalization were as follows:

- To break the ownership and control of banks by a few business families.
- To prevent concentration of wealth and economic power.
- To mobilize savings of the masses from every nook and corner of the country.

To pay more attention to the priority sectors of the economy like agriculture and small scale industries, the post-nationalization period saw a remarkable expansion in the banking and financial system. The biggest achievement of nationalization was the reallocation of sectoral credit in favor of agriculture, small scale industries and exports. Within agriculture, credit for the procurement of food grains, i.e., food credit was a major thing. Other agriculture activities included poultry farming, dairy and piggery. Certain other sectors of the economy which also received attention for credit allocation were professionals, self-employed individuals, artisans and other weaker sections of the\ society. Conversely, there was a sharp fall in bank credit to large scale industries. However, the share of small-scale industry registered an upward trend. Nationalization of commercial banks had many pros and cons for the economy. The government paid more attention to agriculture than industry. The country witnessed increasing numbers of bank branches in the rural areas. Branch expansion program resulted in mobilization of savings from all parts of the country.

Commercial Banking

A **commercial bank** is a type of **bank** that provides services such as accepting deposits, making business loans, and offering basic investment products.

Structure of commercial bank

The commercial banks can be broadly classified under two heads:

1. Scheduled Banks:

Scheduled Banks refer to those banks which have been included in the Second Schedule of Reserve Bank of India Act, 1934.

In India, scheduled commercial banks are of three types:

(i) Public Sector Banks:

These banks are owned and controlled by the government. The main objective of these banks is to provide service to the society, not to make profits. State Bank of India, Bank of India, Punjab National Bank, Canada Bank and Corporation Bank are some examples of public sector banks. Public sector banks are of two types:

(a) SBI and its subsidiaries;

(b) Other nationalized banks.

(ii) Private Sector Banks:

These banks are owned and controlled by private businessmen. Their main objective is to earn profits. ICICI Bank, HDFC Bank, IDBI Bank is some examples of private sector banks.

(iii) Foreign Banks:

These banks are owned and controlled by foreign promoters. Their number has grown rapidly since 1991, when the process of economic liberalization had started in India. Bank of America, American Express Bank, Standard Chartered Bank are examples of foreign banks.

2. Non-Scheduled Banks:

Non-Scheduled banks refer to those banks which are not included in the Second Schedule of Reserve Bank of India Act, 1934.

Functions of commercial banks

1. Primary or Principle functions
2. Secondary or Subsidiary function

1. Primary or Principle functions

A. Receiving deposits

Accepting various types of deposits is an important function of the commercial banks. Deposits constitute the main sources of the funds for commercial banks. Deposits are of various types like demand deposits, savings deposits and fixed deposits.

a) Demand deposits

Demand deposits also known as current deposits are those which can be withdrawn by the depositor at any time by means of cheques. The bank does not pay any interest on demand deposits. In fact, a bank makes a small charge on the customers with a current account. It is convenient for businessmen to pay creditors by drawing cheques and also get the cheques received by them collected.

b) Savings deposits

Savings deposits are those deposits on which a bank pays a certain percentage of interest to the depositors but the bank places certain restrictions on their withdrawals. For instance, today in India only 150 withdrawals in a year are allowed by the banks. Further the total amount withdrawals that can be made is restricted to Rs.20, 000. Or 10% of the credit balance in the customer's accounts whichever is greater. A proper and satisfactory introduction is necessary to open savings bank account. These accounts are meant for encouraging thrift and a habit of savings among the people.

c) Fixed deposits

There are deposits which can be withdrawn after the expiry of a specified fixed period these are also called time deposits. The rate of interest is higher than that allowed on savings deposit. The fixed deposits are withdrawn by surrendering the fixed deposit receipts, obtained from the bank at the time of depositing the money.

B.Lending of funds

The bank lends fund by means of loans, overdrafts, cash credits and discounting of bills.

a) Loan

Loan is financial accommodation under which bank grants an advance on a separate account called loan account. Interest is charged on the entire amount of loan sanctioned. Loans are given to all types of persons against the personal security of the borrower or against the personal movable or immovable properties.

b) Overdraft

An overdraft is a financial accommodation under which a current account holder is permitted to overdraw his account upto an agreed limit. Interest is charged on the exact amount overdrawn by the customer. It is granted against the security of the borrower. It is advantageous to the borrower because interest is charged only on the amount actually overdrawn by him.

c) Cash credit

A cash credit is a financial accommodation under which an advance is granted on a separate account called cash credit account upto a specified limit. Interest is charged on the amount made use of by the borrower. It is granted against the security of goods or personal security of one or more persons other than the borrower. Traders prefer cash credit to direct loans as they need not pay interest on the entire amount.

d) Discounting of bills

Discounting of bills is a financial arrangement under which a customer holding a bill of exchange can get a loan equivalent to the value of the bill, less discount. The discount represents interest on the money lent for the unexpired period of the bill. On
maturity, the banker collects the proceeds of the bill from its acceptor.

C. Investment of funds on securities

Investment of funds in securities is one of the important functions of commercial banks; they invest a considerable amount of their funds in Government and industrial securities.

2. Secondary or subsidiary Functions

The secondary or subsidiary functions of a bank can be divided into two classes, viz

a) Agency service

Agency services are those services which are rendered by the bank as an agent of their customer. They are:

- Collection of cheques, drafts, etc. on behalf of the customer.
- Payment of bills of exchange, life insurance premium etc., on behalf of the customer.
- Purchase and sale of securities on behalf of the customer.
- Arranging for transfer of money from one place to another on behalf of the customer.
- Acting as a trustee, executors, administrators and attorney.
- Acting as correspondents of other banks and financial institutions.
- Banks also issue credit cards to their customers.

b) General utility services

These are the services rendered not only to the customers but also to the general public as well.

- Accepting valuables and securities for safe custody
- Providing foreign exchange to the importers and exporters.
- Issuing of travelers cheques, circular notes, etc
- Underwriting shares, debentures and Govt securities.
- Acting as referees and providing information relating to the credit worthiness of their customer.

 Collection of information useful to the customers or to the general public and their publication

 Banker may institute scholarship endowment establish book banks for the benefit of the students, arrange exhibitions and undertake any such other activities beneficial to the community in general.

Role of commercial banks in socio economic development

Banks help in accelerating the economic growth of a country in the following ways:

1. Accelerating the Rate of Capital Formation:

Commercial banks encourage the habit of thrift and mobilise the savings of people. These savings are effectively allocated among the ultimate users of funds, i.e., investors for productive investment. So, savings of people result in capital formation which forms the basis of economic development.

2. Provision of Finance and Credit:

Commercial banks are a very important source of finance and credit for trade and industry. The activities of commercial banks are not only confined to domestic trade and commerce, but extend to foreign trade also.

3. Developing Entrepreneurship:

Banks promote entrepreneurship by underwriting the shares of new and existing companies and granting assistance in promoting new ventures or financing promotional activities. Banks finance sick (loss-making) industries for making them viable units.

4. *Promoting Balanced Regional Development:*

Commercial banks provide credit facilities to rural people by opening branches in the backward areas. The funds collected in developed regions may be channelised for investments in the under developed regions of the country. In this way, they bring about more balanced regional development.

5. *Help to Consumers*:

Commercial banks advance credit for purchase of durable consumer items like Vehicles, T.V., refrigerator etc., which are out of reach for some consumers due to their limited paying capacity. In this way, banks help in creating demand for such consumer goods.

Services rendered by commercial banks

1. Accepting Deposit

Accepting deposit from savers or account holders is the primary function of bank. Banks accept deposit from those who can save money, but cannot utilize in profitable sectors.People prefer to deposit their savings in a bank because by doing so, they earn interest.

2. Advancing Of Loans

Banks are profit oriented business organizations. So they have to advance loan to public and generate interest from them as profit. After keeping certain cash reserves, banks provide short-term, medium-term and long-term loans to needy borrowers.

3. Discounting of bill of exchange

Bill of exchange is a negotiable instrument, which is accepted by the debtor, drawn upon him/her by the creditor and agrees to pay the amount mentioned on maturity. Discounting bill of exchange is another function of modern commercial bank. Under this, banks purchase bill of exchange from holder in discount after making some marginal deduction in the form of commission. The banks pay the deducted value to the holders when traders discount it into bank.

4. Cheque Payment

Banks provide cheque pads to the account holders. Account holders can draw cheque upon bank to pay money. Banks pay for cheques of customers after formal verification and official procedures. .

5. Remittance

Remittance is a system, through which cash fund is transferred from one place to another. Banks provide the facilities of remittance to the customers and earn some service charge.

6. Collection and Payment Of Credit Instruments

In modern business, different types of credit instruments such as bill of exchange, promissory notes, cheques etc. are used. Banks deal with such instruments. Modern banks collect and pay different types of credit instruments as the representative of the customers.

7. Foreign Currency Exchange

Banks deal with foreign currencies. As the requirement of customers, banks exchange foreign currencies with local currencies, which is essential to settle down the dues in the international trade.

8. Consultancy

Modern commercial banks are large organizations. They can expand their function to consultancy business. In this function, banks hire financial, legal and market experts, who provide advices to customers in regarding investment, industry, trade, income, tax etc.

9. Bank Guarantee

Customers are provided the facility of bank guarantee by modern commercial banks. When customers have to deposit certain fund in governmental offices or courts for specific purpose, bank can present itself as the guarantee for the customer, instead of depositing fund by customers.

Credit creation and deployment of funds

• An important function performed by the commercial banks is the creation of credit.

• The process of banking must be considered in terms of monetary flows, that is, continuous depositing and withdrawal of cash from the bank.

• It is only this activity which has enabled the bank to manufacture money.

• Therefore the banks are not only the purveyors of money but manufacturers of money.

Basic of Credit Creation

The basis of credit money is the bank deposits. The bank deposits are of two kinds viz.,

(1) Primary deposits, and

(2) Derivative deposits.

Primary Deposits:

• Primary deposits arise or formed when cash or cheque is deposited by customers.

• When a person deposits money or cheque, the bank will credit his account.

• The customer is free to withdraw the amount whenever he wants by cheques.

• These deposits are called “primary deposits” or “cash deposits.”

• It is out of these primary deposits that the bank makes loans and advances to its customers.

• The initiative is taken by the customers themselves. In this case, the role of the bank is passive.

• So these deposits are also called “passive deposits.” These deposits merely convert currency money into deposit money. They do not create money.

• They do not make any net addition to the stock of money. In other words, there is no increase in the supply of money.

Derivative Deposits:

• Bank deposits also arise when a loan is granted or when a bank discounts a bill or purchase government securities.

• Deposits which arise on account of granting loan or purchase of assets by a bank are called “derivative deposits.”

• Since the bank play an active role in the creation of such deposits, they are also known as “active deposits.”
• Thus, credit creation implies multiplication of bank deposits. Credit creation may be defined as “the expansion of bank deposits through the process of more loans and advances and investments.”

** Process of Credit Creation**
• An important aspect of the credit creating function of the commercial banks is the process of multiple-expansion of credit.
• The banking system as a whole can create credit which is several times more than the original increase in the deposits of a bank.
• This process is called the multiple-expansion or multiple-creation of credit.
• Similarly, if there is withdrawal from any one bank, it leads to the process of multiple contraction of credit.
The process of multiple credit-expansion can be illustrated by assuming:
a) The existence of a number of banks, SBI, BARODA, AXIS etc., each with different sets of depositors.
b) Every bank has to keep 20% of cash reserves, according to law, and,
c) A new deposit of Rs. 1,000 has been made with SBI to start with.
Limitation on Credit Creation
The commercial banks do not have unlimited power of credit creation. Their power to create credit is limited by the following factors:
1) Amount of Cash Cash
2) Reserve Ratio
3) Banking Habits of the People
4) Nature of Business Conditions in the Economy
5) Leakages in Credit-Creation
6) Sound Securities
7) Liquidity Preference
8) Monetary Policy of the Central Bank

Role of RBI as a regulator
The central bank of the country is the Reserve bank of India(RBI). It was established in April 1935 with a share capital of Rs.5 crores on the basis of the recommendations of the Hilton young Commission. The share capital was divided into shares of Rs.100 each fully

paid which was entirely owned by private shareholders in the beginning. The Govt held shares of nominal value of Rs.2, 20,000.

RBI was nationalized in the year 1949. The general superintendence and direction of the bank is entrusted to central Board of Directors of 20 members, the Governor and four deputy Governors, one Govt official from the Ministry of finance, ten nominated Directors by the central Govt to represent the four local Boards with the headquarters at Mumbai, Kolkata, Chennai and New Delhi. Local Boards consists of five members each central Govt appointed for a team of four years to represent territorial and economic interests and the interests of co-operative and indigenous banks. The Reserve Bank of India Act 1934 was commenced on April1, 1935. The Act, 1934 (II of 1934) provides the statutory basis of the functioning of the bank. The bank was constituted for the need of following:

- To regulate the issue of banknotes.
- To maintain reserves with a view to securing monetary stability
- To operate the credit and currency system of the country to its advantage.

Role of GOI as a regulator of Banking System

Bank regulations are a form of government regulation which subject banks to certain requirements, restrictions and guidelines. This regulatory structure creates transparency between banking institutions and the individuals and corporations with whom they conduct business, among other things. Given the interconnectedness of the banking industry and the reliance that the national (and global) economy hold on banks, it is important for regulatory agencies to maintain control over the standardized practices of these institutions. Supporters of such regulation often hinge their arguments on the "too big to fail" notion. This holds that many financial institutions (particularly investment banks with a commercial arm) hold too much control over the economy to fail without enormous consequences. This is the premise for government bailouts, in which government financial assistance is provided to banks or other financial institutions who appear to be on the brink of collapse. The belief is that without this aid, the crippled banks would not only become bankrupt, but would create rippling effects throughout the economy leading to systemic failure.

Objectives of bank regulation

Objectives of bank regulation, and the emphasis, vary between jurisdictions. The most common objectives are:

1. Prudential—to reduce the level of risk to which bank creditors are exposed (i.e. to protect depositors)
2. Systemic risk reduction—to reduce the risk of disruption resulting from adverse trading conditions for banks causing multiple or major bank failures
3. Avoid misuse of banks—to reduce the risk of banks being used for criminal purposes, e.g. laundering the proceeds of crime
4. To protect banking confidentiality
5. Credit allocation—to direct credit to favored sectors
6. It may also include rules about treating customers fairly and having corporate social responsibility (CSR)

General principles of Bank regulation

• **Minimum requirements**

Requirements are imposed on banks in order to promote the objectives of the regulator. Often, these requirements are closely tied to the level of risk exposure for a certain sector of the bank. The most important minimum requirement in banking regulation is maintaining minimum capital ratios. To some extent, U.S. banks have some leeway in determining who will supervise and regulate them.

• Supervisory review

Banks are required to be issued with a bank license by the regulator in order to carry on business as a bank, and the regulator supervises licensed banks for compliance with the requirements and responds to breaches of the requirements through obtaining undertakings, giving directions, imposing penalties or revoking the bank's license.

• **Market discipline**

The regulator requires banks to publicly disclose financial and other information, and depositors and other creditors are able to use this information to assess the level of risk and to make investment decisions. As a result of this, the bank is subject to market discipline and the regulator can also use market pricing information as an indicator of the bank's financial health.

UNIT II

- Bank Balance-Sheet; Basic operations of Banks; Bankers; Customer relationship;
- Payment and Collection of cheques and other negotiable instruments; opening of accounts of various types of customers.
- Loans and Advances: Principles of sound bank lending; Different types of loans; Credit appraisal techniques; Credit management and credit monitoring;

Balance Sheet of a Bank

The balance sheet of the bank is different from the balance sheet of the company and it is prepared only by the banks according to the mandate by the Bank's Regulatory Authorities in order to reflect the tradeoff between the profit of the bank and its risk and its financial health.

Balance Sheet for banks is different from other sectors and companies. There are several characteristics of the bank's financial statement that highlight how banks balance sheets and income statements are created. Sales are not measured by ratios like sales turnover and receivables turnover. Once investors are comfortable with the terminology and can grasp the statements, it becomes elementary for them to analyze the trends and understand the statements.

Banks Balance Sheet Example

Balance Sheet Assets

We note that the bank's balance sheet assets are different from what we usually see in other sectors like Manufacturing etc. The classification is not based on current assets, long term assets, inventory, payables, etc.The key highlight is that bank assets include securities purchased, loans, financial instruments, etc.

Balance Sheet Liabilities

The Bank's balance sheet liability section looks very different from the ordinary liabilities (current liabilities, long term liabilities, etc.).Here the key terms to note are Deposits, Securities under repurchase agreements, short term and long term borrowings, etc.

Components of Banks Balance Sheet

The main components of the above bank's balance sheet are

1 – Cash

- For other sectors, holding a large amount of cash is considered a loss in opportunity cost. But in the case of Banks Balance Sheet, cash is a source of income and is held on deposit. Sometimes banks also hold cash for other banks, and one of the significant services which banks provide is to provide cash on demand.
- Due to the nature of its business and also as per regulatory norms, banks must have a minimum amount of liquid cash. Most often, banks keep excess reserves for higher safety Goldman Sachs has a considerable amount of cash balance.
- In 2017 it had ~12% of its balance in cash and equivalents. This is an essential focus for the investors, since the chances of receiving a higher amount of dividend or share buyback increases

2 – Securities

- These instruments are typically short-term in nature, and banks generate a yield from these kinds of investments. Banks own US Treasuries and municipal bonds.
- These securities are liquid and can be easily sold in the secondary market and hence are termed as secondary reserves. Goldman has increased its investment in securities in 2017.

3 – Loans

Lending money and earning interest is the primary business of the bank. It can be termed as bread and butter of the bank.

	As of December 2017		
$ in millions	Loans Receivable	Loans, at Fair Value	Total
Corporate loans	$30,749	$ 3,924	$34,673
Loans to Private Wealth Management clients	16,591	7,102	23,693
Loans backed by:			
Commercial real estate	7,987	1,825	9,812
Residential real estate	6,234	1,043	7,277
Marcus loans	1,912	–	1,912
Other loans	3,263	983	4,246
Allowance for loan losses	(803)	–	(803)
Total	**$65,933**	**$14,877**	**$80,810**

- From an investor's perspective, the increase in loans is an essential factor for the growth of the bank. Along with the increase in loans, bank deposits should also be observed. An increase in loans is alone not sufficient. The quality of creditors should be noted. Poor quality of creditors may lead to a rise in default rates and, in turn, a loss for the banks.
- On a broad level, banks provide Personal and mortgage loans. Personal loans are given without any security, and hence interest for these loans remains high. In the case of mortgage loans, the loan is given against a mortgage, and the interest is lower. But if the loan taker defaults on its loan, the mortgage is claimed by the bank as per agreement.
- Banks also provide loans for business, real estate loans, which include but not limited to residential loans, home equity loans and commercial mortgages, consumer loans, and interbank loans.

4 – Deposits

Deposits fall under the liability portion of the banks' balance sheet and are also mainly the most substantial liability for the bank. It includes money market, savings, and current account and has both interest and non-interest bearing accounts.

- Deposits are considered liabilities, but they are also crucial in determining a bank's ability to lend. If the bank does not have sufficient deposits, it will not be able to lend, and the loan growth will also be hampered. Banks may have to take on debt to meet the loan growth, which would cost them more than the rate they might receive on loans.
- Also, this is not a sustainable way for banks to grow their loans. After a certain point, the debt amount will reach an extent where the bank will not get any credit, and if the bank fails to pay on its payments, it will lead to a crash.
- Banks use these liabilities to generate more income, which earns them additional income. By using these deposits to finance loans for individuals etc. Banks will be able to leverage this additional capital to make the extra income that they might have otherwise earned through the capital.
- Banks also have an allowance in the balance sheet for covering losses, and the changes in this amount are based on the economic conditions.

- **Accounting Rules for Valuing Assets in a Bank**

Capital is determined by Total Assets, less total liabilities (also known as net worth). However, the recent changes have changed this definition and have made it complex to determine the true value of the bank's net worth.Post-2009 crisis, the government took specific initiatives to restore faith in the banking system. Financial Accounting Standards Board has allowed Banks to value their assets at a Fair Value. Banks are now also allowed to record income on the income statement if the market value of the debt decreases. This change is because the bank could buy its debt in the market and reduce the debt amount.

Important Indicators in Banks Balance Sheet Analysis

The word “Default” means failure to meet interest or payment obligations. Usually, banks use a Non-performance ratio, which is a percentage indicating the number of loans given on credit is expected to fail. This comparison helps us in understanding if the bank has sufficient funds to meet the future contingencies
Widely used ratios include –

1. Non-performing loans / Customer loans
2. Non performing loans / Customer loans + collateral
3. Non-performing loans / Average total assets
4. Own Resources / Average total assets

Non-performing assets or loans to loans ratio is used as a measure of the overall quality of the bank’s entire loan book. Not performing loans are the ones for which interest is overdue for more than 3 months
The third ratio is especially significant for institutions that are already in a bad place. When this ratio crosses a benchmark, it is considered as a strong sign of insolvency
The higher fourth the ratio indicates that the bank is highly leveraged and there is lower protection against defaults on the loans mentioned above on the asset side

Types of relationship between banker and customer
1. General feature of the relation
□□Commencement of primary general relationship
The primary general relationship between a banker and a customer starts from the time the customer opens a bank account by depositing money.

□□Contractual primary general relationship
The primary general relationship between a banker and a customer arises from a contract between the two. So, it is a contractual relationship. As it is a contractual relationship, it is governed by the various terms of agreement between the two parties.

□□Nature of primary general relationship
When a banker receives deposits of money from a customer, he is neither a bailee nor a trustee nor an agent, but only a debtor of the customer. This view has been endorsed by several authorities on banking law and also confirmed by many court decisions.

□□Not a bailee or depositors of customer’s money
A banker is not a bailee or depositary of customer’s money. This is because a bailee accepts the bailment of certain things on the condition that the things bailed will not be utilized by him and the identical things will be returned. But a banker doesn’t accept the money from the customer on the condition that the money deposited with him will not be

utilized by him and that the identical money (i.e. the same currency notes or coins deposited with him by the customer) will be returned.

- Not a trustee of customer’s money

A banker is not a trustee of the customer’s money. This is because a trustee is required to use the trust money in accordance with the trust deed, render an account to the beneficiary for everything he does with the money and is bound to handover the profits earned from the use of trust money to the beneficiary. But a banker is not bound to employ the customer’s money in accordance with the terms of any trust deed is not required to render an account to the customer for everything he does with the money and is not the use of the customer’s money.

- Not an agent in respect of customer’s money

When a banker accepts deposits of money from a customer, he is not an agent of the customer. This is because an agent is bound to act according to the instructions of the principal, while investing the principal’s money, render a detailed account for everything he does with the principal’s money to the principal and is required to handover to the principal the incomes he earns from the use of principal’s money.

- Only a debtor in respect of customer’s money

The banker is just a debtor and the customer is a creditor when he accepts and has the deposits of the customer. Of course, in case the customer’s account is overdrawn or the customer has taken loan or any other form of financial accommodation from the banker, the customer becomes the debtor and the banker becomes the creditor. So, one can conclude that the primary relationship between a banker and a customer is that of a debtor and a creditor and their respective positions are determined by the existing state of the bank account.

Subsidiary feature of the relationship

- Bailee and bailer relationship

When a banker accepts valuable and documents form a customer for safe custody, he becomes a bailee and the customer becomes a bailer. As a bailee, the banker owes some duties and liabilities to the customer. They are:

a) He is required to safeguard the safe custody deposits of the customer in his hands with reasonable care.

b) It he fails to take reasonable care in the preservation of the safe custody deposits and the customers suffers loss as a consequence; he becomes liable to compensate the customer for the loss.

In this context, it should be noted that the banker is liable only for the losses arising out of his negligence and not for those losses arising out of reasons beyond his control, such as fire, burglary, etc. this is because, a banker is only a bailee and not an insurer of the safe custody deposits left with him.

c) He is required to handover the safe custody deposits to the depositor, whenever he demands them back.

Trustee and beneficiary relationship

A banker becomes the trustee of his customer, when he is entrusted with some trust work. For instance, when a customer deposits a certain sum of money with the banker with specific instructions to use the same for a specific purpose, the bankers becomes the trustee of the customer in respect of that money until that purpose is fulfilled.

Agent and principal relationship

When a banker undertakes agency services such as collection cheques, drafts & bills, collection of interest and dividends on securities, payment of premium and subscriptions, purchase and sale of securities, etc, for a customer, he becomes the agent and the customer becomes the principal.

As an agent the banker owes some duties to the customer they are:

He is required to act in accordance with the instruction of the principal, i.e. the customer.

He is bound to return to the customer all the incomes which he earns as an agents of the customer.

Banker's obligation to customers

Obligation to honor his customer's cheques. .

Obligation to maintain the secrecy of the customer's account

Interest rate related complaints.

Right of lien

The legal **right** of a creditor to sell the collateral property of a debtor who fails to meet the obligations of a loan contract. A **lien** exists, for example, when an individual takes out an automobile loan.

The condition of the right are:

1. The agent should be lawfully entitled to receive from the principal a sum of money by way of commission earned or disbursements made or services rendered in the proper execution of the business of agency.

2. The property over which the lien to be exercised should belong to the principal and it should have been received by the agent. The property is considered to be sufficient in the possession of the agent where he has been dealing with it. Thus where an auctioneer was engaged to sell\ furniture at the owner's house, he was held to be sufficiently in possession to exercise lien for his commission. The property held by an agent for a special purpose implicitly excludes the right. Similarly, where possession is obtained without the principal's authority or by fraud or misrepresentation, there is no lien, briefly, the agent's possession must be lawful.

3. The agent has only a particular lien. A particular lien attached only to that specific-matter in respect of which the charges are due. No other property can be retained.

Right of Setoff

• Set-off means- that the bank can adjust the credit balance in a customer's account against a debit balance in another account maintained by the same customer.

• In an ongoing, situation, the right of set-off can be exercised by a banker- by serving a reasonable notice on the customer.

• The right of set-off can be exercised by the banker only when the relationship between the customer and the banker is that of- Debtor and Creditor.

• The banker can exercised the right of set-off only in respect of- debts due and determined.

• The following condition are required to be fulfilled before a banker can exercise the right of set-off- (a)The debt must be a sum certain and due immediately, (b) The debt must be due by and to the same parties and the in the same right, (c) There should be no agreement to the contrary.

• The right to set-off account arise immediately in the following cases- (a) On the death, mental incapacity or insolvency of a customer, (b) On the insolvency of a firm, or on the liquidation of a company, (c) On the receipt of garnishee order.

• The right of set-off is available to the banker only in respect of- credit balance held in a customer's account.

• In case of time barred debt- the bank can exercise the right of set-off provided the debts are due in the same sight.

• Money held in a fixed deposit account may be set-off against an overdraft allowed to the same customer- only after the fixed deposit has matured for payment.

• For exercising the right of set-off- no document is required to be obtained from the customer.

Right of appropriation

1. The act of setting aside money for a specific purpose. A company or a government appropriates funds in order to delegate cash for the necessities of its business operations. This may occur for any of the functions of a business, including setting aside funds for employee salaries, research and development, dividends and all other uses of cash.

Federal funds must be appropriated each year for government programs. In business use, may also be known as "capital allocation."

2. The claiming of land or intellectual property by a company or organization, or otherwise marking ownership of previously unclaimed or contested property.

Banker’s legal duty of disclosure and related matters

The banker's duty of confidentiality to the customer

It is an implied term of the contract between customers and their banks and building societies that these firms will keep their customers’ information confidential. This confidentiality is not just confined to account transactions – it extends to all the information that the bank has about the customer. But from time to time, mistakes happen and – for whatever reason – banks end up releasing information that they should have kept secret. Sometimes, the resulting breach of confidentiality is little more than technical (in other words, nothing really flows from it), but occasionally it can have major consequences.

The Tournier principles

First of all, a banker’s duty of confidentiality is not absolute. The 1924 case of Tournier v National Provincial and Union Bank of England sets out four areas where a bank can legally disclose information about its customer. These principles still hold good today and are:

• Where the bank is compelled by law to disclose the information
• if the bank has a public duty to disclose the information
• if the bank’s own interests require disclosure; and
• Where the customer has agreed to the information being disclosed.

If we decide that a bank disclosed information under one or more of these circumstances, then we are unlikely to interfere. But most of the complaints we receive involve situations where the bank should not have disclosed information – because none of the Tournier principles applied.

Liability

If a bank discloses information about a customer in any circumstances other than those described above, then it has acted wrongly and should, as a general rule, be held liable for the reasonably foreseeable consequences of its action. Some banks seem to think it should make a difference if they disclosed the information by accident – but it does not. If a bank’s carelessness leads to a breach of confidentiality that does not diminish the fact that the bank acted in breach of a fundamental duty it owed to its customer. It is relatively rare for us to come across a case where information was disclosed deliberately. Mostly, it happens by accident.

Consequences of a breach of confidentiality

Customers rightly expect high standards from their banks and building societies. So if they discover that their private information has been wrongly divulged to someone else, they can become very unhappy – even if the disclosure has resulted in little more than minor frustration or embarrassment. But even a minor mistake by a bank can lead to significant problems – particularly if the customer is running a business. We have seen cases where simple clerical errors have led to serious business losses.

The important point here is for the bank to look at the consequences of its actions for the customer – and to distinguish clearly between "loss" and "distress and inconvenience". All too often we find that banks fail to do this properly. Even where they accept they have done something wrong, they often try to settle the matter by offering the customer some money without first assessing either:

Whether the customer has experienced a true (and reasonably foreseeable) financial loss; or

The real extent to which the customer has suffered distress, embarrassment, or inconvenience.

Loss

Both banks and customers need to take a realistic look at any real losses resulting from the bank's breach of confidentiality. The bank should generally be liable for losses that it could reasonably have foreseen when it disclosed the information.

In our experience, banks regularly fail to pay proper attention to the true costs that customers can incur as a direct result of the breach of confidentiality. The key, therefore, is for both parties to analyse and understand the true effects of the bank's actions.

Distress and inconvenience

Occasionally, customers who have experienced minimal or no financial loss feel that their "good name" has been "irreparably damaged" by what has happened. They may go on to claim large sums of money as compensation, perhaps quoting high-profile court cases. However, we take a more balanced view.

In exceptional circumstances we might award compensation of some hundreds of pounds for significant breaches of confidentiality. But any compensation we award is generally far more modest. Minor mistakes will warrant little more than a nominal payment, if any. When assessing compensation for distress and inconvenience we follow the approach outlined inour technical briefing note awards for non-financial loss.

Customers account with banks

Opening Savings Bank Account

A Savings bank account is the most common operating account for individuals and others for non-commercial transactions. A Savings account helps people to put through day-to-day banking transactions besides earning some return on the savings made. Banks generally put some ceilings on the total number of withdrawals permitted during specific time periods. Banks also stipulate certain minimum balance to be maintained in savings accounts. Normally a higher minimum balance is stipulated in cheque operated accounts as compared to non-cheque operated accounts. Banks as a rule do not give overdraft facility in a saving account, but allow occasional overdrawing to meet contingencies.

Who can open a Savings Account?

* By a person in his / her name;

* By two or more persons in their joint names payable to:

- Both or all of them or the survivor or survivors of them; OR

- Either or any more of them or the survivor or the survivors of them; OR

- Former / latter or survivor of a particular person during his lifetime or survivors jointly or survivor.

* Certain non-profit welfare organizations are also permitted to open Savings bank accounts with banks.

What a bank asks for while opening an account?

Banks are required to know true identity of the person wanting to open an account. Banks also seek introduction of the person from an existing account holder. Banks require photograph of the person to be kept on record for future identification purpose. In terms of government notification w.e.f. 01.11.1998, banks have to obtain PAN numbers (issued by Income Tax Dept.) of the account holder at the time of opening of the account. In the absence of PAN number customer should give a declaration in the prescribed format (form no.60 or 61 as the case may be).

What the Customer needs to know while opening a Savings Account?

Ask the bank officials about :

• Minimum balance requirements.

• Penal provisions if the balance falls below the minimum stipulated amounts or return of Cheques issued or instruments sent on collection.

• Collection facilities etc. offered and charges applicable.

• Details of charges, if any for issue of cheque books and limits fixed on number of withdrawals, cash drawings, etc.

Fixed or Time Deposits

Time deposits are deposits accepted by banks for a specified period of time. In terms of RBI directives the minimum period for which term deposits can be accepted is 15 days. The banks generally do not accept deposits for periods longer than 10 years.

1. Banks pay interest on term deposits based on the period of deposits and normally pay higher interest for longer term deposits.

2. Banks have full discretion to fix their interest rates on deposits and these rates are varied from time to time depending on market conditions.

3. Changes made in interest rates from time to time do not alter the interest paid on the existing deposits.

4. When banks quote a certain percentage of interest per annum for a given period it is understood that interest payments are made on a quarterly basis (see IBA Master Charts).

5. The depositor can collect interest on every quarter or its discounted value at monthly rests or avail quarterly compounding benefits and receive principal and interest on maturity.
6. RBI has now permitted banks to quote a higher rate of interest for individual deposits more than Rs.15 lacs.
7. Banks are allowed to levy a penalty for premature encashment of deposits at their discretion. Banks generally pay interest on such deposits as applicable for the period which deposit has been kept with the bank (less penalty if levied).
8. Bank allow loans against the fixed deposits on demand. Margin retained over the deposit outstanding and interest rate charged thereon are decided by the bank and may vary from bank to bank.

Opening of a time deposit Account

Normally the requirements as given under savings bank account apply to time deposits also. However, photographs are not insisted for deposits below Rs.10,000/-. Also the requirements regarding furnishing of PAN number applies only to time deposits over Rs.50,000/- made in cash.

Time deposits - Product variations

To suit the needs of the customers banks have introduced innovative variations in the basic time deposit format. Flexible deposit is one such innovation. In this case a given deposit is split into units of smaller amounts for accounting purposes. This enables the customer to encash any number of units prematurely at any time during the currency of the deposit and earn the contracted rate of interest on the balance amount.

Current Account

Current accounts are cheque operated accounts maintained for mainly business purposes. Unlike savings bank account no limits are fixed by banks on the number of transactions permitted in the Account. Banks generally insist on a higher minimum balance to be maintained in current account. Considering the large number of transactions in the account and volatile nature of balances maintained overnight banks generally levy certain service charges for operating a Current account.

In terms of RBI directive banks are not allowed to pay any interest on the balances maintained in Current accounts. However, legal heirs of a deceased person are paid interest at the rates applicable to Savings bank deposit from the date of death of the account holder till the date of settlement.

Operation

KYC and Operation

• KYC (Know Your Customer) is a framework for banks which enables them to know / understand the customers and their financial dealings to be able to serve them better.
• Banking operations are susceptible to the risks of money laundering and terrorist

financing. Therefore, banks are advised to follow certain customer identification procedure for opening of accounts and monitoring transactions of a suspicious nature for the purpose of reporting it to appropriate authority.

• Reserve Bank of India has advised banks to make the Know Your Customer (KYC) procedures mandatory while opening and operating the accounts and has issued the KYC guidelines under Section 35 (A) of the Banking Regulation Act, 1949.

• Any contravention of the same will attract penalties under the relevant provisions of the Act. Thus, the Bank has to be fully compliant with the provisions of the KYC procedures.

When does KYC apply?

- Opening a new account.
- In respect of accounts where documents as per current KYC standards have not been submitted while opening the initial account.
- Opening a Locker Facility where these documents are not available with the Bank for all the Locker facility holders.
- When the Bank feels it necessary to obtain additional information from existing customers based on conduct of account.
- When there are changes to signatories, mandate holders, beneficial owners etc.
- For non-account holders approaching the Bank for high value one-off transactions like Drafts, Remittances etc.

Advantages of KYC

• Sound KYC procedures have particular relevance to the safety and soundness of banks, in that:

1. They help to protect banks' reputation and the integrity of banking systems by reducing the likelihood of banks becoming a vehicle for or a victim of financial crime and suffering consequential reputational damage;
2. They provide an essential part of sound risk management system (basis for identifying, limiting and controlling risk exposures in assets & liabilities

Objective of KYC guidelines

• To prevent banks from being used, intentionally or unintentionally, by criminal elements for money laundering activities. KYC procedures also enable banks to know/understand their customers and their financial dealings better which in turn help them manage their risks prudently. 4 key elements of KYC policies

1) Customer Acceptance Policy;
2) Customer Identification Procedures;
3) Monitoring of Transactions; and
4) Risk management

Types of Account

One of the main functions of a commercial bank is to accept deposits of money from the public. The deposit accepted by a bank may be classifies into two broad categories

Time Deposits Demand Deposits
1. Fixed Deposits 1. Savings Deposits
2. Recurring Deposits 2. Current Deposits

Time Deposits

The time deposits are repayable after expiry of a fixed specified period time while demand deposits are repayable on demand.

i) **Fixed deposits**

Fixed deposits are those deposits, which are repayable after the expiry of a fixed specified period of time. They are also called time deposits. The time or period of deposit may vary from fifteen days to several years. This period decided by the depositor according to his convenience. The rate of interest is usually higher than other types of deposits. The rate of interest on fixed deposit depends on period of deposit; the longer the period of deposit, the higher will be the rate of interest. The RBI decides the interest rate. On the deposit being made, the banker issues a 'deposit receipts'

ii) **Recurring deposit**

Recurring deposits are variants of fixed deposits. Recurring deposits are also repayable only after the expiry of a fixed specified period of time but the amount is deposited in monthly installments. These deposits are meant for people having regular monthly income. The duration of recurring deposits varies from six months to several years. Generally the rate of interest on these deposits is higher.

Demand Deposits

i) **Savings Deposits**

Savings bank accounts are introduced by banks to mobilize small savings and inculcate the habit of savings in the people. These deposits are repayable on demand, but bank places certain restrictions on the number of withdrawals. These deposits can be opened with very small amount. The prescribed minimum balance is different in different banks. Interests is paid on monthly minimum balances and credited to the respective accounts half yearly according to the rates prescribed by the RBI from time to time.

ii) **Current Accounts or Current Deposits**

Current accounts are those deposits, which are repayable on demand. There are no restrictions on the number of withdrawals. The bank don't pay interest on current account or deposits, instead they change incidental charge on customers having current account. This type of deposit is suitable for businessmen who want to make payments by means of cheques.

Types of customers

Lunatics

A lunatic is person of unsound mind (irresponsible person). The position of lunatics under Indian law, Under Indian contract Act, a contract with or by a lunatic are void. The reason being the lunatic being of unsound mind is not competent to comprehend a contract. If the banker without knowing that the person is lunatic opens an account and enters into a contract acting in good faith is protected. But when once he gets a notice of lunacy of a person, he should not entertain any contract either existing or new.

Drunkards

Under section 12 of Indian contract Act 1872, a sane man who is delirious from favor or who is drunk that he can't under the contract, or form rational judgment can't enter into contract while delirium or drunkenness lasts. When a customer who is drunk presents a cheque across a counter the payment must be witnessed.

Minors

Under section 3 of the Indian majority act, 1875, a minor is a person who has not completed the age of 18 years. In case a guardian to the person or property of minor is appointed by the court, or the property of the minor is placed under the charge of court wards before he completes the age of 18 years, he continues to be a minor until he completes the age of 21 years.

Married women

The law that exists today in India doesn't make any distinction between the contractual capacity of a man or an unmarried lady and a married woman. So, a married woman enjoys the same contractual capacity as a man or an unmarried lady. She can acquire and sell property, lend or borrow and enter into contracts and bind her personal or separate property called "Stridhan".

Partnership firm

Section 4 of partnership act 1932, defines partnership as "the relation between persons who have agreed to share the profits of a business carried on by all or any of them acting for all". So, a partnership is an association of two or more persons who agree to carry on a business jointly and share the profits of that business. The person who form the partnership are called "partners" individually and a "firm" collectively. The name under which they carry on the business is called "firm name". They can open the account in their firm's name.

Joint stock companies (Public Limited Companies)

A joint stock company is an association of persons under the companies act. It is an artificial person created by law with perpetual succession and common seal. A joint stock company is a separate legal entity. So, a bank account can be opened in its name. However, while opening and maintaining an account in the name of public limited company, a banker has to be very careful. He is required to take the following precautions in dealing with a public limited company:

1. He should call for and examine the original certificate of incorporation to ascertain whether the company is legally incorporated or not. The certificate of incorporation is the conclusive proof of the incorporation of the company. It is also advisable for the banker

to obtain and retain under his custody a certified copy of the incorporation certificate for his future reference.

2. He should obtain a certified copy of the memorandum of association of the company as amended up to date and ascertain the objects for which the company is formed, the authorized capital of the company and the liability of the members of the company. A knowledge of the objects of the company as specified in the Memorandum of association is absolutely necessary for the banker, because any act done, or contract entered by the company, which is outside the scope of the objects, is ultra-virus, (i.e. beyond the powers of company) and is, therefore not binding on the company.

Trustee

Section 3 of Indian Trust contact Act, 1882 defines a trust as an obligation annexed to the ownership of property and arising out of a confidence reposed in and accepted by the owner or declared and accepted by him for the benefit of another or of another and the owner" so, a trustee is person to whom the management of a property is entrusted by one in trust, i.e. out of confidence reposed in him, for the benefit of another. In short, a trustee is one who manages a trust.

Nomination

Nomination is a facility that enables a deposit account holder(s) (individual or sole proprietor) orsafe deposit locker holder(s) to nominate an individual, who can claim the proceeds of the deposit account(s) or contents of the safe deposit locker(s), post the demise of the original depositor(s) or locker holder(s).

Benefit of nomination

The benefit of nomination is that in the event of death of an account holder(s) or locker holder(s), the Bank can release the account proceeds or contents of the locker to the nominee(s) without insisting upon a Succession Certificate, Letter of Administration or Court Order. The nominee holds the monies in the capacity of a Trustee on behalf of the legal heirs of the deceased account holder(s) or locker holder(s) and the Bank's liability is duly discharged on payment to the Nominee.

Who can nominate?

• Bank account holders having deposit accounts in their individual names or in joint names of two or more individuals can appoint a nominee to their accounts.

• A sole proprietor can appoint a nominee to the sole proprietorship account with the bank.

• In the case of a deposit account in the name of a minor, nomination shall be made by a person lawfully entitled to act on behalf of the minor in respect of a deposit account.

• Safe deposit locker holder(s) can appoint nominee(s) on their Safe deposit locker(s).

• A nomination can be made only in respect of a deposit account which is held in the individual capacity of the depositor, and not in any representative capacity such as the holder of an office like Director of a Company, Secretary of an Association, partner of a firm, or Karta of an HUF.

How can register a nomination?

Specific nomination forms need to be completed and submitted to the Bank for registering the nomination facility. Different forms are applicable to register nominations on deposit accounts and safe deposit lockers. The Bank will acknowledge receipt of the nomination form and send a confirmation of having recorded the same. This confirmation must be kept securely either with the deposit account holder or with the nominee, if the account holder so wishes.

Settlement of death claims

An announcement of death in newspaper, production of a death certificate or a report from a reliable source etc., will be sufficient notice to the Bank about the death of the Account Holder. As soon as the Branch becomes aware of the death of the A/C Holder, it will record the fact in the relevant account in the system and stop operation in the A/C.

Intimation to the Nominee, if any:

If the deceased A/C holder had appointed a nominee, a letter will be issued to the nominee informing him/her about the death of the account holder.

Further operation in the Account:

Further operation in the different types of account will be allowed as follows:-

a) Individual A/Cs:

No further cheques should be paid even though they be dated prior to the date of death of the A/C holder.

b) Joint A/Cs:

If the balance is payable to the survivor(s), cheques signed by the survivor(s) may be paid to the debit of the a/c, but it is preferable that survivor(s) is/are advised to close the a/c and transfer the balance to a new a/c in his/her/their name(s)., Fresh Account Opening Form duly filled in and

signed by the survivor(s) should be obtained. If the balance is not payable to the survivor(s), the a/c should be stopped.

c) Proprietary A/Cs:

No further cheques should be paid even though they be dated prior to the date of death of the A/C holder.

d) Partnership A/Cs:

The death of a partner has, ordinarily, the legal effect of dissolving the firm. The surviving partner(s) can, however, operate the A/C for the purpose of winding up; and any cheques drawn by the surviving partner(s) can be paid. Cheques drawn by the deceased partner and presented\ after his death, should not be paid. The branches should request the surviving partner(s) to close the a/c by drawing a cheque signed by all of them and open a new a/c through which all further transactions may be passed.

e) Joint Hindu Family Firm A/c:-

In case of death of the Karta, the operation in A/c should be stopped.

f) Trust A/cs.:-

The Trustees have to act jointly unless there is an express provision to the contrary in the Trust Deed. In case of death of any, trustee, the operation on the a/c should be stopped unless the, relative Trust Deed confers express powers on the surviving trustee to act. In the absence of any specific provision in the Trust Deed, it is not safe for the Bank to assume that the surviving trustees possess full powers to deal with the A/C. Branches should, therefore, not allow the

surviving trustees to operate on the a/c or withdraw the balance. In case of death of sole trustee, operation on the A/C should be immediately stopped.

g) Executor's and Administrator's A/C: -

On the death of an executor or administrator unless otherwise provided for the in the Will or Probate or Letter of Administration, all the powers of the office bearers become vested in the surviving executors or administrators. , The a/c should be allowed to be operated by co-executor(s), but the cheques signed by the deceased executor or administrator and presented after notice of his death should not be paid in

the a/c. In case of death of a sole Executor or Administrator, it will be necessary to obtain fresh order of the court appointing a new Administrator.

h) Limited Company's A/Cs:

Where notice of death is received in respect of a person who is authorized to operate an A/C of a Limited Co., outstanding cheques drawn by such person of the Company can still be paid. The Board resolution submitted by the Company regarding the operation of its A/C should beexamined by the branch to see whether any amendment or new resolution is necessary.

i) Association, Society, club A/c.:

The instructions given in respect of Limited Company's A/Cs shall also apply to A/Cs of Association, Society, Club etc.

j) Accounts operated by a holder of Power of Attorney or Letter of Mandate:

Upon the death of the principal, the authority of Attorney or Mandate holder stands cancelled. The operation on the a/c should be immediately stopped and no cheques signed by Attorney/Mandate holder should be paid after receipt of notice of death of the Principal.

The Negotiable Instruments Act 1881

- In India law relating to negotiable instruments is contained in negotiable instruments Act 1881.
- "A negotiable instrument means a promissory note, bill of exchange or cheque payable either to order or to bearer".

Features of Negotiable Instruments

1. Negotiability- it means transferability. It can be transferred without any formality.
2. Property- The possessor of negotiable instrument is presumed to be the owner of the property contained therein.
3. Equivalent to cash- Even though is a document it is as good as cash.
4. Recovery- The transferee of the negotiable instrument can sue in his own name, in case of dishonor for the recovery of the amount without giving notice to the debtor.
5. Contract- A negotiable instrument is a contract to pay money.
6. Prompt payment-A negotiable instrument enables the holder of the instrument to expect prompt payment.
7. A negotiable instrument can be transferred any number of times till it is at maturity and the holder of the instrument need not give any notice of transfer to the debtor

Important concept and explanations under the Negotiable Instruments Act

The Paying Banker

The bank on which a cheque is drawn (the bank whose name is printed on the cheque) and which pays the amount for which the cheque is written and deducts that sum from the customer's account.

A Banker who holds the account of the drawer of the cheque and is obliged to make payment, if the funds of the customer are sufficient to cover the amount of he cheque drawn or if overdrawing facility is given to the customer**.**

Protection Available to PayingBanker

• Banker’s Protection Negotiable Instruments Act 1881
• Certain Sections of the Act

Cheque

A cheque is a bill of exchange drawn on a specified banker and not expressed to be payable otherwise than on demand. That is the drawer directs the bank to pay a certain sum to payee on his demand.

(A bill of exchange is an instrument in writing containing an unconditional order, signed by the maker, directing the banker to pay a certain sum of money only to or to the order of a certain person or to the bearer of the instrument)

Definition

“A bill of exchange drawn upon a specified banker and payable on demand”

Rules

1. All Cheques are bill of exchange but all bill of exchanges are not Cheques.
2. Usually banks provide their customers with printed cheque forms which are filled up and signed by the drawer.
3. The signatures must tally with specimen signature of the drawer kept in the bank.
4. A cheque must be dated.
5. A cheque becomes due for payment on the date specified in it.

6. A cheque drawn on a future date is valid but it is payable on and after the date specified. Such Cheques are called postdated Cheques.

Essentials of a Cheque

1. It must be unconditional order
2. It must be in writing
3. It must be drawn on a specified banker
4. it must be signed by the drawer
5. The order must be for the payment of a certain sum of money only
6. Drawer, drawee and payee must be certain
7. The payee must be certain
8. The amount must be payable on demand

Dishonor of Cheques

□□A negotiable instrument may be dishonored by non-payment or non-acceptance.
□□A cheque and promissory note may be dishonored by non-payment and
□□a bill of exchange may be dishonored either by;

1. Non acceptance or by
2. Nonpayment.

1. Dishonor by Non Acceptance

A bill of exchange is said to be dishonored by any one of the following **reasons;**

a) If the drawee does not accept the bill within 48 hrs from the time of presentment
b) If there are several drawees and all of them do not accept
c) When the presentment of acceptance is excused, and the bill is not accepted. (Say some excuse for acceptance)
d) When drawee become insolvent or died
e) When the drawee gives a limited acceptance
f) When the drawee is incompetent to contract
g) When the drawee is a fictitious person

2. Dishonour by Non-Payment

A promissory note, bill of exchange, or cheque is said to be dishonoured by nonpayment if the maker fails to make payment on the date of maturity.

A cheque is dishonored by non payment as soon as a banker refuses to pay.

Notice of dishonour

□□When a negotiable instrument is dishonoured the holder must give notice of dishonour to all the prior parties

Notice by whom?

1. Notice by holder or any other a party
2. Chain method of notice of dishonour

3. Notice by principal or agent

Form of Notice

1. It may be oral or written
2. Clearly indicate the reason for dishonour
3. It must be given within in a reasonable time

Circumstances when a banker is bound to dishonour of a cheque

1. When the customer countermands payment
2. Garnishee order (issued by high court)
3. Death, Insolvency or insanity of the customer
4. Notice of assignment (letter to transfer)
5. Defective title of the party
6. Loss of cheque
7. Postdated or stale cheque
8. When the cheque is irregular (may change cheque book, any information missing)
9. Closing of account
10. On transfer of accounts
11. When a cheque is Mutilated (Torn)
12. When there is material alteration
13. When the amount in words and figures differs
14. If the cheque is undated
15. he cheque is not presented in banking hours

Negotiation

It is the transfer of an instrument from one person to another in such a manner so as to convey the title and constitute the transferee the holder thereof. It may be;

a. Negotiable by mere delivery

Payable even to agent to keep it for payee

b. Negotiable by endorsement and delivery

Unless the holder signs his endorsement on the instrument, the transferee does not become a holder.

Endorsement

The literal meaning of the word endorsement is writing on the back of an instrument. Under the NI Act, it means, writing of the name of the endorsee on the back of the instrument by the endorser under his signature with the object of transferring the rights therein. If an instrument is fully covered with endorsements and no space is left, further endorsement can be made on a slip of paper (called **alonge**) annexed thereto

Kind of Endorsement

1. Blank or general endorsement

Just put the signature 0of endorser without mention the name of endorsee

Eg: sd/-

D.Mohan

2. Special or full endorsement
Including the name of endorsee
Eg: Pay to Ghosh or order sd/-
D.Mohan
3. Restrictive endorsement
An endorsement, when it prohibits or restricts the further negotiation of the instrument.
Eg: pay to Ghosh only sd/-
D.Mohan
4. Conditional or Qualified
An endorsement is conditional or qualified if it limits or negates the liability of the endorser
Eg: pay to ghosh on Signing a receipt Sd/-
D.mohan
5. Partial endorsement
When an endorser endorses only a part of the amount mentioned in the instrument. it is irregular

The collecting Banker

A Collecting Banker is one who undertakes to collect various types of instruments representing money in favour of his customer or his own behalf from the drawers of these instruments; some are negotiable instruments as provided for in the negotiable instruments Act. 1881 and some are quasi negotiable instruments.

Duties & Responsibilities of Collecting Bankers:

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

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

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

Presenting the instrument in due time: It is the responsibility of the collecting bank to present the instrument in due time to the paying bank.

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

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

Collecting Banker's Protection:

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

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

- The cheque he collected is a crossed cheque.
- He collected such crossed cheque only for his customer as an agent & not as a holder for value.
- He collected such crossed cheque in good faith and without negligence.

Negligence

There are a variety of ways in which a bank can be considered to be negligent in undertaking its duties towards its customers, many of which are noted in the discussion above by implication. In broad terms, for the customer to raise the issue, it will be necessary to challenge the efficiency of the security mechanisms put in place by the bank or offer a credible alternative explanation for what happened.

Bill of exchange

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

Three parties:

- The maker of bill of exchange is called the drawer.
- The person who is directed to pay is called the drawee.
- The person who will receive the money is called the payee

Specimen of bill of exchange

□□Rs 5000 Place.

Date.

On demand pay to Rajesh or order, the sum of Rs 5000/- (Rupees Five thousand only) for value
received.

To Ajith Sd- Stamp

(Address) Babu

□□Here Babu is the drawer

□□Ajith is the drawee (Acceptor)

□□Rajesh is the payee

Essentials of bill of exchange

• The instrument must be in writing.
• The instrument must contain an order to pay.
• There must be three parties.
• The instrument must be signed by the drawer.
• The amount of money to be paid must be certain.
• The payee must be certain.
• It must comply with the formalities as regards date, stamp etc.

Promissory note

"A promissory note is an instrument in writing containing an unconditional undertaking signed\ by the maker, to pay a certain sum of money only to or to the order of a certain person or to the bearer of the instrument".

Two parties:

 The person who makes the promissory note and promises to pay is called the maker.
 The person to whom the payment is to be made is called the payee.
 Eg I promise to pay A or order Rs 500.

Essentials of a promissory note

1. Pro notes must be in writing
2. A Promise to pay must be express.
3. Definite and unconditional
4. To be signed by the maker
5. Certainty in the case of parties.
6. Certainty in the case of sum of money
7. Promise to pay money only
8. Formalities are not essential. Formalities like time, place registration Number etc is not required. But it must be stamped as per stamp act.
9. It may be payable on demand or after a definite period of time - Where there is no time is mentioned the note is payable on demand.

Discharge of negotiable instruments

 An instrument is said to be discharged when all rights of action under it are completely extinguished and when it ceases to be negotiable.

 This would happen when the party who is ultimately liable on the instrument is discharged from liability.

 In such a case even in holder in due course does not acquire any right under the instrument

Modes of Discharge

1. by payment.
2. By Debtor as a holder
2. By express waiver- holder gives up his right.
3. By cancellation-holder may cancel the instrument.

4. by material alteration or lapse of time.

Discharge of a party or parties

1. By payment
2. By cancellation
3. By release (let loose)
4. By allowing drawee more than 48 hours
5. By delay in presentment of cheque
6. Cheque payable to order (fraudlent payee)
7. By operation of law
8. By material alteration
9. By taking limited acceptance
10. By not giving notice of dishonour

Hundis

A **hundi** is a financial instrument that developed in Medieval India for use in trade and credit transactions. **Hundis** are used as a form of remittance instrument to transfer money from place to place, as a form of credit instrument or IOU to borrow money and as a bill of exchange in trade transactions.

Types of Hundis

- **Sahyog Hundi**: This is drawn by one merchant on another, asking the latter to pay the amount to a third merchant. In this case the merchant on whom the hundi is drawn is of some 'credit worthiness' in the market and is known in the bazaar. A sahyog hundi passes from one hand to another till it reaches the final recipient, who, after reasonable enquiries, presents it to the drawee for acceptance of the payment. Sahyog means co-operation in Hindi and Gujrati, the predominant languages of traders. The hundi is so named because it required the co-operation of multiple parties to ensure that the hundi has an acceptable risk and fairly good likelihood of being paid, in the absence of a formalized credit monitoring and reporting framework.
- **Darshani Hundi**: This is a hundi payable on sight. It must be presented for payment within a reasonable time after its receipt by the holder. Thus, it is similar to a demand bill.
- **Muddati Hundi**: A muddati or miadi hundi is payable after a specified period of time. This is similar to a time bill.

Nowadays, banks are working on providing more lucrative and easy business loans options for the first time business owners. For existing businesses, loan is provided in the following ways:

Types of loans

Home Loan

Home Loans are taken by people for a variety of home-related purposes such as construction of home, home renovation, home extension, buying of property or land, or payment of stamp duties. Home loans comprise an adjustable or fixed interest rate and payment terms. Some types of home loans are mentioned below:

- Home Purchase Loan
- Land Purchase Loan
- Home Construction Loan
- Home Extension Loan
- Home Renovation Loan
- Stamp Duty Loan
- NRI Home Loans
- Loan Against Property

Personal Loan

This type of loan is given to individuals after accessing their credentials based on their profession or business, or any other sources of income. The loan can be utilised for any purpose, for example, paying debt, marriage expenses or vacation expenditure. No collateral security is required for this type of loan. The span of personal loan repayment varies from 12 months to 60 months depending upon the principal amount and the EMIs. The interest rate ranges from 15 percent to 28 percent varying from bank to bank. Approximately 2 percent of the total loan amount is charged as the loan processing fee. Generally, banks rules prohibit prepayment of loan for the initial six months; otherwise 2 percent to 4 percent of the outstanding amount is charged as the prepayment fees. The EMI starts once the disbursement of loan has been made.

Business Loan

This type of loan is provided to either existing businesses or those venturing into new business. As banks provide loans on the basis of individual's credentials, it is bit difficult to get a loan for starting a business. It is very important for individuals (starting a business) to have a clear cut business plan as it is the most important requirement to convince the banks that your business has the capability of repayment. Banks then rely on individual's background, assets/property, previous loan history and dedication towards work. Banks also prefer those individuals who have already insured the property for their business. Nowadays, banks are working on providing more lucrative and easy business loans options for the first time business owners. For existing businesses, loan is provided in the following ways:

Term loans – Amount provided for a fixed tenure at the applicable interest rate: three years for short term loan and 10-15 years for long term loans.

Bank overdraft limits – Ability to withdraw more money than what is deposited.

Bill Discounting – Short-term borrowing used to improve a company's working capital and cash flow position.

Letter of credit for international business – Bank guaranteeing of a buyer's payment to a seller in specified period.

Education Loan

Required by and provided to students who want to pursue higher education in resident country or abroad. Students should have an admission offer from an institution before they apply for an education loan. The loan takes care of the fees of the institution including examination and library fees; travel expenses for abroad; cost of books and equipments required; any insurance for the student, if applicable; and any additional expenses such as tours, thesis, project work, etc. The terms of education loans vary from bank to bank. The RBI has fixed certain norms on the total amount of loan that can be disbursed; however, banks can increase or decrease the limit depending on the institution. For studying in India, Rs. 10 lakh is the average and for studying abroad, the average is Rs. 20 lakh. For a loan amount up to Rs. 4 lakh, parents should be the joint borrowers and above that amount, a guarantee or some security in terms of tangible assets is required, depending upon the bank. Simple rate of interest is charged depending upon the base rate of the bank. It is not mandatory to pay the interest during the study period; however, if paid regularly during the study period, some concession is also provided by a few banks. The repayment tenure varies between 10 years and 15 years depending upon the loan amount and repayment begins between six months and two years of the course completion. Early repayment has no associated charges.

Gold Loan

Gold loan is imparted only on providing gold as security to a bank or any other lending institution. It is considered as one of the safest methods as the loan amount is provided on the basis of the security submitted. Amount ranging from Rs. 5k to 25 lakh can be taken as loan against gold. Amount equivalent to 80 percent to 90 percent (varying from bank to bank) of the total value of the gold is given as loan to the borrower. Depending upon the bank, the tenure of gold loan varies from one day to two years. The extension of tenure is also allowed by few banks. The rate of interest usually ranges from 14 percent to 24 percent, depending upon the financial institution. The banks charge processing fees of up to 1.5 percent. There is no prepayment fee. You can repay the gold loan any time during the tenure. EMI policy also varies from bank to bank; few banks prefer EMIs where interest and principal are charged monthly, whereas few only charge the interest on a monthly basis and offer flexibility for the payment of the interest amount.

Vehicle/ Car Loan

Compared to other loans, it is easier and simpler to take vehicle loans. Vehicle loans involve less paperwork and around three to six working days are required to get the clearance. The interest rates vary from bank to bank based on their base rate. The repayment process involves monthly EMIs and early repayment options

Overdraft facilities

An overdraft occurs when money is withdrawn from a bank account and the available balance goes below zero. In this situation the account is said to be "overdrawn". If there is a prior agreement with the account provider for an overdraft, and the amount overdrawn is within the authorized overdraft limit, then interest is normally charged at the agreed rate. If the negative balance exceeds the agreed terms, then additional fees may be charged and higher interest rates may apply.

Reasons for overdrafts

Overdrafts occur for a variety of reasons. These may include:

Intentional short-term loan - The account holders finds themselves short of money and knowingly makes an insufficient-funds debit. They accept the associated fees and cover the overdraft with their next deposit.

Failure to maintain an accurate account register - The account holder doesn't accurately account for activity on their account and overspends through negligence.

ATM overdraft - Banks or ATMs may allow cash withdrawals despite insufficient availability of funds. The account holder may or may not be aware of this fact at the time of the withdrawal. If the ATM is unable to communicate with the cardholder's bank, it may automatically authorize a withdrawal based on limits preset by the authorizing network.

Temporary Deposit Hold - A deposit made to the account can be placed on hold by the bank. This may be due to Regulation CC (which governs the placement of holds on deposited checks) or due to individual bank policies. The funds may not be immediately available and lead to overdraft fees.

Unexpected electronic withdrawals - At some point in the past the account holder may have authorized electronic withdrawals by a business. This could occur in good faith of both parties if the electronic withdrawal in question is made legally possible by terms of the contract, such as the initiation of a recurring service following a free trial period. The debit could also have been made as a result of a wage garnishment, an offset claim for a taxing agency or a credit account or overdraft with another account with the same bank, or a direct-deposit chargeback in order to recover an overpayment.

Merchant error - A merchant may improperly debit a customer's account due to human error. For example, a customer may authorize a $5.00 purchase which may post to the account for $500.00. The customer has the option to recover these funds through chargeback to the merchant.

Chargeback to merchant - A merchant account could receive a chargeback because of making an improper credit or debit card charge to a customer or a customer making an unauthorized credit or debit card charge to someone else's account in order to "pay" for goods or services from the merchant. It is possible for the chargeback and associated fee to cause an overdraft or leave insufficient funds to cover a subsequent withdrawal or debit from the merchant's account that received the chargeback.

Authorization holds - When a customer makes a purchase using their debit card without using their PIN, the transaction is treated as a credit transaction. The funds are placed on hold in the customer's account reducing the customer's available balance. However the merchant doesn't receive the funds until they process the transaction batch for the period during which the customer's purchase was made. Banks do not hold these funds indefinitely, and so the bank may release the hold before the merchant collects the funds thus making these funds available again. If the customer spends these funds, then barring an interim deposit the account will overdraw when the merchant collects for the original purchase.

Bank fees - The bank charges a fee unexpected to the account holder, creating a negative balance or leaving insufficient funds for a subsequent debit from the same account.

Playing the float - The account holder makes a debit while insufficient funds are present in the account believing they will be able to deposit sufficient funds before the debit clears. While many cases of playing the float are done with honest intentions, the time involved in checks clearing and the difference in the processing of debits and credits are exploited by those committing check kiting.

Returned check deposit - The account holder deposits a check or money order and the deposited item is returned due to non-sufficient funds, a closed account, or being discovered to be counterfeit, stolen, altered, or forged. As a result of the check chargeback and associated fee, an overdraft results or a subsequent debit which was reliant on such funds causes one. This could be due to a deposited item that is known to be bad, or the customer could be a victim of a bad check or a counterfeit check scam. If the resulting overdraft is too large or cannot be covered in a short period of time, the bank could sue or even press criminal charges.

Intentional Fraud - An ATM deposit with misrepresented funds is made or a check or money order known to be bad is deposited (see above) by the account holder, and enough money is debited before the fraud is discovered to result in an overdraft once the chargeback is made. The fraud could be perpetrated against one's own account, another person's account, or an account set up in another person's name by an identity thief.

Bank Error - A check debit may post for an improper amount due to human or computer error, so an amount much larger than the maker intended may be removed from the account. Some bank errors can work to the account holder's detriment, but others could work to their benefit.

Victimization - The account may have been a target of identity theft. This could occur as the result of demand-draft, ATM-card, or debit-card fraud, skimming, check forgery, an "account takeover," or phishing. The criminal act could cause an overdraft or cause a subsequent debit to cause one. The money or checks from an ATM deposit could also have been stolen or the envelope lost or stolen, in which case the victim is often denied a remedy.

Intraday overdraft - A debit occurs in the customer’s account resulting in an overdraft which is then covered by a credit that posts to the account during the same business day. Whether this actually results in overdraft fees depends on the deposit-account holder agreement of the particular bank.

Discounting of bills

Bill of Exchange, is an instrument in writing which is an unconditional order to pay a certain amount of money to a specified person. The transaction is practically an advance against the security of the bill and the discount represents the interest on the advance from the date of purchase of the bill until it is due for payment. Under certain circumstances, the Bank may discount a bill of exchange instead of negotiating them.

□□The seller who is the holder of a accepted B/E has two options :

1. Hold on the B/E till maturity and then take the payment from buyer.
2. Discount the B/E with discounting agency.

Discount:

□□Seller can take the accepted B/E to a discounting agency and obtain ready cash.

□□The act of giving accepted B/E for ready money is call discounting the B/E.

□□The difference between ready money paid and the face value of the bill is called the discount.

Types of Bills

1. Demand Bill: This is payable immediately “at sight” or “on presentment” to the drawee. A bill on which no time of payment or “due date” is specified is also termed as a demand Bill.
2. Usance Bill: This is also called time bill. The term usance refers to the time period recognized by custom or usage for payment of bills
3. Documentary Bill: These are the B/Es that are accompanied by documents that confirm that a trade has taken place between the buyer and the seller of goods. These documents include the invoices and other documents of title such as railway receipts, lorry receipts and bills of lading issued by custom officials.
4. Clean Bill: These bills are not accompanied by any documents that show that a trade has taken place between the buyer and the seller. Because of this, the interest rate charged on such bills is higher than the rate charged on documentary bills.

Creation of a B/E

Suppose a seller sells goods or merchandise to a buyer. In most cases, the seller would like to be paid immediately but the buyer would like to pay only after some time, that is, the buyer would wish to purchase on credit. To solve this problem, the seller draws a B/E of a given maturity on the buyer. The seller has now assumed the role of a creditor; and is called the drawer of the bill. The buyer, who is the debtor, is called the drawee. The seller then sends the bill to the buyer who acknowledges his responsibility for the payment of the amount on the terms mentioned on the bill by writing his acceptance on the bill. The acceptor could be the buyer himself or any third party willing to take on the credit risk of the buyer.

Financing book dates and supply bills

When a bank receives a deposit of checks from a payee, it will credit the payee's account with the funds represented by the checks. However, the bank has not really received the cash yet, since it must still collect the funds from the bank of the paying party. Until the bank collects the funds, it is at risk of having a negative cash flow situation if the payee uses the cash it has just received. To avoid this risk, the bank posts the amount of the deposit with a value date that is one or more days later than the book date. This value date is the presumed date of receipt of the cash by the bank. Once the value date is reached, the payee has use of the funds. The value date may be categorized by the bank as 1-day float, 2+-day float, or some similar term.

Charging of security bills

Charging of security is done by banks to safe guard their advances by taking different kinds of securities reason being to fall back on it in case of loan is defaulted.

Type of Charges

Assignment – it is a mode of providing security to a banker for an advance includes transfer of a right, property or debt.

Lien – right of the banker to retain possessions of the goods and securities owned by thedebtor until debt due is paid

Set-off – Total or partial merging of a claim of one person against another in a counterclaim by the latter against the former.

Mortgage – Transfer of interest in immovable property to secure an advanced loan or an existing debt or performance of an obligation.

Pledge – Bailment of goods for providing security for payment of debt or performance of promise.

Hypothecation – Charge upon any movable property created by a borrower in favor of a secured creditor without delivery of possession of the movable property, also called as a mortgage of a movable property.

Pledge

Bailment of goods as security for payment of debt or performance of a promise :PLEDGE

Bailer: PAWNER

Bailee: PAWNEE

Example:

A borrows Rs.100 from B & keeps his watch as security : pledge

Rights of Pawnee

Right of retainer: right to retain goods until dues paid

Right of transfer for subsequent advances:: on lending money to same debtor without further security ;right to retain earlier goods extends

Right to extraordinary expenses

Right to sue the pawnor or sell the goods on default.

Rights of Pawnor

Enforcement of pawnee’s duties

Defaulting pawnor’s right to redeem

Mortgage

A mortgage loan, also referred to as a mortgage, is used by purchasers of real property to raise capital to buy real estate; or by existing property owners to raise funds for any purpose while putting a lien on the property being mortgaged. The loan is "secured" on the borrower's property. This means that a legal mechanism is put in place which allows the lender to take possession and sell the secured property ("foreclosure" or "repossession") to pay off the loan in the event that the borrower defaults on the loan or otherwise fails to abide by its terms. The word mortgage is derived from a "law French" term used by English lawyers in the Middle Ages meaning "death pledge", and refers to the pledge ending (dying) when either the obligation is fulfilled or the property is taken through foreclosure. Mortgage can also be described as "a borrower giving consideration in the form of a collateral for a benefit (loan).

Standard or conforming mortgages

Many countries have a notion of standard or conforming mortgages that define a perceived acceptable level of risk, which may be formal or informal, and may be reinforced by laws, government intervention, or market practice. For example, a standard mortgage may be considered to be one with no more than 70-80% LTV and no more than one-third of gross income going to mortgage debt.

A standard or conforming mortgage is a key concept as it often defines whether or not the mortgage can be easily sold or securitized, or, if non-standard, may affect the price at which it may be sold. In the United States, a conforming mortgage is one which meets the established rules and procedures of the two major government-sponsored entities in the housing finance market (including some legal requirements). In contrast, lenders who decide to make nonconforming loans are exercising a higher risk tolerance and do so knowing that they face more challenge in reselling the loan. Many countries have similar concepts or agencies that define what are "standard" mortgages. Regulated lenders (such as banks) may be subject to limits or higher risk weightings for non-standard mortgages. For example, banks and mortgage brokerages in Canada face restrictions on lending more than 80% of the property value; beyond this level, mortgage insurance is generally required

Foreign currency mortgage

In some countries with currencies that tend to depreciate, foreign currency mortgages are common, enabling lenders to lend in a stable foreign currency, whilst the borrower takes on the currency risk that the currency will depreciate and they will therefore need to convert higher amounts of the domestic currency to repay the loan

Credit appraisal techniques; Credit management and credit monitoring;

After making a credit decision, successful collection on the loan rests on accurate and comprehensive credit management and monitoring. Loan officers can enhance a credit management and monitoring strategy through improved customer relationships.

Community bankers value the close ties to their communities and are best positioned to develop personal relationships with their customers. Loan officers with genuine customer relationships will have greater insight into the financial position of the individual's business. Furthermore, loan officers will better understand the customer's financial trends and can identify early warning indicators and areas of potential weaknesses.

The following are key areas loan officers should focus on to develop a more robust credit management and monitoring strategy augmented by familiar customer relationships.

Document Financial Information

Annually, officers should obtain updated financial information and tax returns (including all K-1s for business interests). Loan files should routinely show that the information has been reviewed and/or analyzed. In order to determine that the borrower(s) has the on-going capacity to service the outstanding debt, the file should contain:

- An updated analysis showing available cash flow
- Outstanding debt obligations
- Computation for debt service coverage ratio (DSCR) and net debt ratios.

Many borrowers provide personal financial statements (PFS) showing liquid assets, which may have been partially used to approve the credit facility; however, the files often do not include verification of the liquidity (bank statements, brokerage statements, etc.). To further support the borrower’s financial capacity, banks should obtain verification of liquid assets via these statements annually.

Document Officer Comments

Lenders should place greater emphasis on problem relationships. Incorporating officer comments describing the status of loans that are classified or are dynamic in nature is vital to document the file on a routine basis (at least quarterly or more frequently, if necessary). Bank management must reinforce this practice with the loan officers and understand the importance of maintaining updated memos for problem credits on a regular basis that should include action plans, benchmarks and trigger dates. Contained within this action plan there should also be a section for all collateral documents to be reviewed and verified to ensure the bank's collateral position remains protected. This verification should include that all public records have been searched and validated to avoid any unknowns or surprises.While implementing these practices may not reduce the overall risk of loss, it is a proactive approach to identify and measure potential weaknesses and manage loan portfolio problems with performance and time sensitive deadlines.

Credit Monitoring is the tacking of an individual's credit history, for any changes or suspicious activities. A credit monitoring service is will show an individual's credit report provide them with new information regarding new credit inquiries, accounts etc. The individual also can ensure if this information is actually genuine. Credit Monitoring can also be used by individuals to keep a check on their credit score, as well as keep track of them, giving them the option to be well of their credit history before applying for loans and mortgages. The process of monitoring takes many steps to ensure negligent loans in parameters of the credit policy followed when it comes to delinquency. The credit management section will ensure the collection of the loans.

There are many benefits of credit monitoring

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

Credit Information Bureau India Limited or more commonly know as CIBIL is the most critical player in the finance industry. Set up in August 2000, they help many financial institutions with providing loans to customers and even help them manage their business. CIBIL is the credit monitors on the country, they maintain records of an individual's financial transaction history pertaining to loans, credit cards etc. from the many banks and lending institutions in the country. With this information they create reports with will pertain to the individual's financial transaction history, called Credit Information Report which also provide the individual with a score. The score of the individual will allow many banks and financial institutions to provide a loan of any kinds to an individual, since CIBIL has checked his/her repaying capability.

UNIT III

- Sources and Uses of Funds in Banks; Value Chain Analysis in Banking Industry.
- Emerging trends in Banking: Universal Banking, Venture Capital, Project Financing, Merchant Banking, E-Banking, Credit Cards, Banking Ombudsman Scheme.

Sources and Uses of Funds at Commercial Banks

lerm loans

Funds provided by commercial banks for a medium-term period.

lin*e of credit*

Access to a specified amount of bank funds over a specified period of time.

Commercial banks obtain most of their funds by accepting deposits from investors. These investors are usually individuals, but some are firms and government agencies that have excess cash. Some deposits are held at banks for very short periods, such as a month or less. Commercial banks also attract deposits for longer time periods by offering certificates of deposit, which specify a minimum deposit level (such as $1,000) and a particular maturity (such as 1 year). Because most commercial banks offer certificates of deposit with many different maturities, they essentially diversify the times at which the deposits are withdrawn by investors.

Deposits at commercial banks are insured up to a maximum of $100,000 per account by the Federal Deposit Insurance Corporation (FDIC). Deposit insurance tends to reduce the concern of depositors about the possibility of a bank failure, and therefore it reduces the possibility that all depositors will try to withdraw their deposits from banks simultaneously. Thus the U.S. banking system efficiently facilitates the flow of funds from savers to borrowers.

Commercial banks use most of their funds either to provide loans or to purchase debt securities. In both cases they serve as creditors, providing credit to those borrowers who need funds. They provide commercial loans to firms, make personal loans to individuals, and purchase debt securities issued by firms or government agencies. Most firms rely heavily on commercial banks as a source of funds.

Some of the more popular means by which commercial banks extend credit to firms are term loans, lines of credit, and investment in debt securities issued by firms. **Term loans** are provided by banks for a medium-term period to finance a firm's investment in machinery or buildings. For example, consider a manufacturer of toys that plans to produce toys and sell them to retail stores. It will need funds to purchase the machinery for producing toys, to make lease payments on the manufacturing facilities, and to pay its employees. As time passes, it will generate cash flows that can be used to cover these expenses. However, there is a time lag between when it must cover these expenses (cash outflows) and when it receives revenue (cash inflows). The term loan can enable the firm to cover its expenses until a sufficient amount of revenue is generated.

The term loan typically lasts for a medium-term period, such as 4 to 8 years. The interest rate charged by the bank to the firm for this type of loan depends on the prevailing interest rates at the time the loan is provided. The interest rate changed on term loans is usually adjusted periodically (such as annually) to reflect movements in market interest rates.

Commercial banks can also provide credit to a firm by offering a **line of credit,** which allows the firm access to a specified amount of bank funds over a specified period of time. This form of bank credit is especially useful when the firm is not certain how much it will need to borrow over the period. For example, if the toy manufacturer in the previous example was not sure of what its expenses would be in the near future, it could obtain a line of credit and borrow only the amount that it needed. Once a line of credit is granted, it enables the firm to obtain funds quickly.

Commercial banks also invest in debt securities (bonds) that are issued by firms. When a commercial bank purchases securities, its arrangement with a firm is typically less personalized than when it extends a term loan or a line of credit. For example, it may be just one of thousands of investors who invest in a particular debt security the firm has issued. Nevertheless, recognize that a bank's credit provided to firms goes beyond the direct loans that it provides to firms, because it also includes all the securities purchased that were issued by firms.

Banking industry value chain Analysis

Introduction :

A decade later than the financial crisis, the banking industry is now in healthier shape. It has grown bigger in size and more profitable than ever during last 10 years. Its resilience is also much higher compared to a decade ago according to Deloitte. Total assets in the banking industry have reached $124 trillion according to the Banker’s Top 1000 world

Bank’s Rankings for 2018. ROA or Return on Assets stood at 0.9 percent in 2018. However, the U.S. banks are doing better when compared to banks in other parts of the world including Europe. In 2018, the total assets of U.S. based banks reached $17.5 trillion, the highest ever. ROE or Return on equity in the U.S. Banking industry is the highest since the financial crisis at 11.83 percent.
In China too, the banking industry has seen enormous growth. Chinese banks have grown at a better rate compared to the European banks. However, the trade wars between U.S. and China are affecting their growth prospects. Most of the U.S. banks have benefitted from higher interest rates, loan growth and tax cuts. Outside the U.S., banks have benefitted from higher loan demand and by better management of costs. Digital technology has also supported faster growth of the banking industry worldwide. The retail industry worldwide has embraced a mobile centric consumer experience. Larger number of customers are now handling their bank accounts from their mobile devices. The banking industry has changed a lot in a decade. Banks have optimized their value chains since it has helped them bring operational costs down and grow their profitability. The value chain in the banking industry is different from the others. Risks are higher and risk management is an important priority in the banking value chain. Check out an analysis of the primary and secondary activities in banking value chain.

Primary Activities in the Banking industry value chain

Marketing:

Just like the other businesses, marketing has a special significance for the banking industry too. Competition has grown intense in this sector and there are several international players in the market. As such marketing becomes important for banks to overcome competitive pressure too. Attracting and retaining customers requires more focus on marketing. Moreover, segmentation is important for banking and insurance companies as segmentation makes it easier for them to serve the various consumer segments. The banks and insurance companies target different customer segments with suitable plans and services. Brand image is also an important concern for the banking brands.

Most often the brand image is influenced by the service quality. Still, marketing plays an important role in raising brand awareness and it is why banking companies spend as much on advertising and other marketing and promotional activities. Visibility remains an important concern if brands are to expand their customer base. It is also why banks focus heavily on marketing of their brand and financial services. Post-recession growth in the developing countries has remained slow and therefore attracting and retaining customers was somewhat difficult for the brands. So, in this period they were mainly forced to rely upon marketing to retain their customer base. The marketing activities in the banking industry are mainly made up of sales support, branding and advertising activities. However, its overall aim is to maximize profits by driving sales higher and build strong brand awareness.

Sales:

Sales is an important function in the banking value chain which is because of the importance of sales for banks. The banking industry is highly competitive and apart from entering new markets and finding new customers, it is important that the banks also retain their existing customers. The sales function serves a very important role at this point where it does not just sell but also works at customer engagement and retention. Another important thing about this function is that it is the main touch point between the bank and its customers. This function's performance also has an important effect on the bank's image among customers. Sales and service staff being the main connection between the bank and the customers are also partly responsible for marketing.

How they interact with prospective customers and serve them affects the financial institution's image. Now a days online sales have also become more relevant than ever in the banking industry. However, the human touch still plays a core role in driving sales. The role of the sales staff in driving sales and revenue is big. Another factor that has grown the role of sales staff in the banking industry is the expansion of financial services. Banks are managing their sales staff more efficiently and using technology and technological training to help them manage sales more efficiently.

Product:

The products offered by the banks are also an important part of their value chain. From loans to deposits, banks provide several kinds of products and services. However, in a banking context, rather than just having a great product portfolio, it becomes impertinent for the banks to provide great service. Banks provide a series of products and services, some of which are tangible and several intangible. From deposits and loans to credit cards and foreign exchange services, banks offer a large variety of products and services. However, in the banking world, the words products and services generally mean the same thing.

Transactions:

Another primary activity down the value chain of the banking industry is transaction. Technology has made this task easier. Millions of transactions are carried out everyday throughout the world online and offline. From ATMs to online payments, several millions exchange hands in the form of transactions. Variety of payment clearance systems and settlement systems are used by banks globally. Some of them are ACH networks, ATMs, bankcard networks and check clearing systems. Another method of transaction prevalent in the banking sector is the internet based bill payment system. The debit and credit cards have remained at the forefront of this growth in electronic payments. Banks also offer payment services for online businesses. However, apart from banks, other online payment solutions have also emerged led by Paypal. Digital technology has aided the proliferation of banking and payment solutions.

Supporting activities in the banking value chain are as follows:

Technology:

The role of technology has grown increasingly important in the banking world. Specifically, several of the most important developments have taken place during the last two to three decades. Digital technology can also be a source of competitive advantage for the banks since it helps deliver services more efficiently. Technology has made banking easier and also improved the bank's productivity. Several of the services can be availed of online and customers do not always need to go to the branch to receive these services. Now, banks are using technology is every aspect of business including sales, marketing, customer service and other functions. The bank websites play an important role in driving brand awareness, sales, marketing as well as customer acquisition and retention. Digital technology has driven the level of consumer convenience higher in the entire banking industry including the Asian markets.

Human Resources:

Despite the growing role of technology, human resources continue to play an important role in the value chain of the banking industry. Their importance in the banking industry is higher because trust plays an important role in the banking environment globally. Banks train their sales staff and manage them strategically. Not just staff training, banks are also paying special attention to overall management of human capital. They are using digital tools and technology to design effective training programs and to deliver them efficiently. Human resource management is critical in every industry and in the banking industry too the efficiency of staff affects success to a very large extent

Infrastructure:

Infrastructure also plays a key role in the banking industry. From physical infrastructure to technology and particularly IT, infrastructure plays an important role in the growth and functioning of the banks. Due to increased competition, the importance of IT in banking industry has also grown. With growing risks related to data security and privacy, banks are now focusing heavily on maintaining a strong and impenetrable IT infrastructure. Data centers are also a critical part of the IT infrastructures of the banks. The banks have multi level security frameworks in place to protect consumer data.

Risk Management guidelines:

At last, banking is all about risk taking. Several of the inherent rewards in banking are born of risks. Still, it is essential for the banks to properly manage their risks. It is because neither poorly managed and nor excessively managed risks are good for the health of the banks. Risk management guidelines are therefore an important aspect of the banking value chain. It helps the bank managers to manage their risks and reduce or manage them as required. While risks are inherent to banking, if not managed efficiently banks can face serious troubles due to excessive risk taking.

Concept of universal banking

Universal banking is a combination of Commercial banking, Investment banking, Development banking, Insurance and many other financial activities. It is a place where all financial products are available under one roof. So, a universal bank is a bank which offers commercial bank functions plus other functions such as Merchant Banking, Mutual Funds, Factoring, Credit cards, Housing Finance, Auto loans, Retail loans, Insurance, etc.

Advantages of Universal Banking

The benefits or advantages of universal banking are:-

Investors' Trust: Universal banks hold stakes (equity shares) of many companies. These companies can easily get other investors to invest in their business. This is because other investors have full confidence and faith in the Universal banks. They know that the Universal banks will closely watch all the activities of the companies in which they hold a stake.

Economics of Scale: Universal banking results in economic efficiency. That is, it results in lower costs, higher output and better products and services. In India, RBI is in favour of universal banking because it results in economies of scale.

Resource Utilization: Universal banks use their client's resources as per the client's ability to take a risk. If the client has a high risk taking capacity then the universal bank will advise him to make risky investments and not safe investments. Similarly, clients with a low risk taking capacity are advised to make safe investments. Today, universal banks invest their client's money in different types of Mutual funds and also directly into the share market. They also do equity research. So, they can also manage their client's portfolios (different investments) profitably.

Profitable Diversification: Universal banks diversify their activities. So, they can use the same financial experts to provide different financial services. This saves cost for the universal bank. Even the day-to-day expenses will be saved because all financial services are provided under one roof, i.e. in the same office.

Easy Marketing: The universal banks can easily market (sell) all their financial products and services through their many branches. They can ask their existing clients to buy their other products and services. This requires less marketing efforts because of their well-established brand name. For e.g. ICICI may ask their existing bank account holders in all their branches, to take house loans, insurance, to buy their Mutual funds, etc. This is done very easily because they use one brand name (ICICI) for all their financial products and services.

One-stop Shopping: Universal banking offers all financial products and services under one roof. One-stop shopping saves a lot of time and transaction costs. It also increases the speed or flow of work. So, one-stop shopping gives benefits to both banks and their clients.

Disadvantages of Universal Banking

The limitations or disadvantages of universal banking are:-

Different Rules and Regulations: Universal banking offers all financial products and services under one roof. However, all these products and services have to follow different rules and regulations. This creates many problems. For e.g. Mutual Funds, Insurance, Home Loans, etc. have to follow different sets of rules and regulations, but they are provided by the same bank.

Effect of failure on Banking System: Universal banking is done by very large banks. If these huge banks fail, then it will have a very big and bad effect on the banking system and the confidence of the public. For e.g. Recently, Lehman Brothers a very large universal bank failed. It had very bad effects in the USA, Europe and even in India.

Monopoly: Universal banks are very large. So, they can easily get monopoly power in the market. This will have many harmful effects on the other banks and the public. This is also harmful to economic development of the country.

Conflict of Interest: Combining commercial and investment banking can result in conflict of interest. That is, Commercial banking versus Investment banking. Some banks may give more importance to one type of banking and give less importance to the other type of banking. However, this does not make commercial sense.

VENTURE CAPITAL

Venture capital is required for the startup of a new venture and a capital investment is needed after the initial stage of seed funding. Venture capital is the ideal option for companies having a limited operating history and the companies which are too small to raise capital through other popular means. Venture capital investment is highly risky investment and traditionally, companies cannot secure a loan from a bank for venture capital investment or get a debt offering. Venture capital investment banking has been introduced recently to fund venture capital.

The Need for Venture Capital Investment Banking

A venture capital firm is a privately held equity group and most of the venture capital firms have their own funds to invest in the new businesses. Venture capital is the money provided to companies that do not possess a proven record of success and therefore, it is very risky investment. These firms have a set of criteria and screening system which is used to see if the new business has the potential to grow or not.

Most of the venture capital firms do not require funds from external sources. Most of the funds for venture capital come from the person who starts the business and the secondary funds come from the investor who is called **angel investor**.

Most of the venture capital funds started during the initial dot-com boom was profitable and many companies that invested in venture capital got a quick and enormous amount of money in return during this era. Most of the companies that earned profits were public and the venture capital investors got their money back with huge returns as the companies going public sold the shares in open market and got very high value for each share.

The venture capital funding provided more than 20% of returns in the initial dot com boom which attracted many new investors into venture capital funding but it is not true for all cases. The individuals or company investing in venture capital funds faced losses at the end of the dotcom boom. Many of the investors in venture capital face a high amount of risk of losing funds and if the company fails in the new venture and becomes underwater, the investor may lose all the money.

New Banks into Venture Capital Investment Banking

In case the funds are required for a new business, venture capital investment banking is the method which helps the venture capitalist to get loans. Traditional banks do not provide the service of venture capital investment banking because it is a risky provision but with new developments, many new banks are venturing into venture capital investment banking.

To seek finance in the form of loans from banks, the new proposal or business has to undergo a process of screening and has to show a good prospect of return on investment to the venture capital investment bank. In traditional system of banking more than 90% of the proposals of venture capital seeking loans for new projects were rejected by banks but the upcoming venture capital investment banking systems adopted by new banks has the provisions to fund risky ventures.

The New Trend of Venture Capital Investment Banking

In the last few years, many new banks have started venture capital investment banking. The system of venture capital investment banking takes at least three to six months to sanction the funds. The key stage of venture capital investment banking includes the evaluation of the new business. Inventure capital investment banking the proposal is considered through a number of criteria such as the commercial viability of the product or service offered by the company, the background of the business, the potential growth, the management strength and the risks involved in investment.

Different Types Of Banks into Venture Capital Investment Banking Systems

There are many different forms of venture capital investment banking (– through investment banks or merchant banks into venture capitalist).Venture capitalists mostly require finance at some point of investment and the need for investment depends on the stage of business. The capitalist may have well defined financial structure for equities and debts. The additional finance can be arranged through clearing banks, merchant banks or financing houses. Venture capital investment banking system mostly focuses on IPO and large private share offering while merchant banks finances small scale companies, and it even offers equity financing, mezzanine financing and bridge financing. Merchant bank offers finance to companies to bridge gap between the public offering and venture capital.

Venture Capital Investment Banking Vs. Finance through Individuals

Venture capital investment banking system is a better option for getting finance than individuals for finance because anybody funding for a project may demand a partial control over the business. The venture capital investment banks are contacted by the venture capital firms when the firm requires additional funds after the initial stage of startup.

Key Features of Venture Capital Investment Banking

In venture capital investment banking the bank has many in-house criteria which evaluates the prospects of the startup business and tries to determine the ROI before making any decision of sanctioning funds to the firm in the form of loans for the new business ventures. The venture capital investment banking system helps the new start up businesses to get additional funds and the evaluation process enables the firm to know about the positive and negative aspects of the new proposal and prepare for the new business venture. The venture capital investment banking system not only involves providing funds to a new business but it even helps in subsidizing risky investments. One of the most attractive features of venture capital investment banking is that it is highly subsidized as compared to other means of financing.

Ways Used By Banks in Venture Capital Investment Banking to ensure Flow Of Income

There are numerous ways used by banks in the venture capital investment banking system to ensure a regular flow of income such as -real estate, financial advising and private equity. Evaluating the risks in investment is the major job of the venture capital investment banking system and the banks may not provide the loans if it considers the proposal too risky and unprofitable for investment.

PROJECT FINANCE

Introduction

Project finance refers to the funding of long-term projects, such as public infrastructure or services, industrial projects, and others through a specific financial structure. Finances can consist of a mix of debt and equity. The cash flows from the project enable servicing of the debt and repayment of debt and equity.

Understanding Project Finance

The structure of project financing relies on future cash flows for repayment of the project finances. The assets or rights held under the project act as collateral for the finance. Governments or companies prefer project finance for long gestation projects or for joint venture arrangements or collaboration arrangements.

Project finance model adopted in BOT (build, operate, and transfer) model contains multiple key elements. The funds are arranged through a special purpose vehicle (SPV). A company may carry the project themselves or subcontract a portion of the project. In the absence of revenues during the construction phase, the interest on debt capital is paid after the commencement of operations.

Project financing is for projects which carry high risks on the capital employed. There is no revenue for the companies participating until the commencement of operations. During the construction phase, there may be one or two offtake agreements, but no revenue streams. There is no recourse available to the parties funding the projects.

The project generally remains off the balance sheet for the financing parties and the government. Companies typically hold the project debt in a subsidiary with a minority holding. This helps in maintaining the debt ratios of the company. For the government, they may wish to keep the project off their balance sheet to have more fiscal room.

Conclusion

In project financing, the lenders have limited recourse. This means that in the case of a default, the lenders have recourse to the assets under the project, securing completion and using performance guarantees under the project. The project financing is contrary to recourse financing, where the lenders get a full claim to the owner's assets or cash flows. Hence, project financing requires sound financial and relevant technical knowledge.

MERCHANT BANK

♣ **Definition of 'Merchant Bank':-** 1) A bank that deals mostly in (but is not limited to) international finance, long-term loans for companies and underwriting. Merchant banks do not provide regular banking services to the general public. 2) A financial institution that specializes in services such as acceptance of bills of exchange, hire purchase or instalment buying, international trade financing, long-term loans, and management of investment portfolios.

♣ **Who is a Merchant Banker?** A merchant banker can be defined as "An organization that acts as an intermediary between the issuers and the ultimate purchasers of securities in the primary security market." A merchant banker is an institution that helps companies to raise capital. It is an organization that underwrites corporate securities, provides advisory services to its clients.

♣ **Meaning:-** A merchant bank is a financial institution which provides capital to companies in the form of share ownership instead of loans. A merchant bank also provides advisory on corporate matters to the firms they lend to. Today, according to the US Federal Deposit Insurance Corporation (acronym FDIC), "the term merchant banking is generally understood to mean negotiated private equity investment by financial institutions in the unregistered securities of either privately or publicly held companies." Both commercial banks and investment banks may engage in merchant banking activities. Historically, merchant banks' original purpose was to facilitate and/or finance production and trade of commodities, hence the name "merchant". Few banks today restrict their activities to such a narrow scope.

♣ **Origin of Merchant Banking:-** The origin of Merchant banking is to be traced to Italy in late medieval times and France during the seventeenth and eighteenth centuries. The Italian merchant bankers introduced into England not only the bill of exchange but also all the institutions and techniques connected with an organized money market. Merchant banking consisted initially of merchant who assisted in financing the transactions of other merchants in addition to their own trade. In France, during seventeenth and eighteenth centuries a merchant banker was not merely a trader but an entrepreneur par excellence. He invested his accumulated profits in all kinds of promising activities. He added banking business to his merchant activities and become a merchant banker

2. **Merchant Banking in India** Merchant banking services strengthen the economic development of a country as they acts as sources of funds and information for corporations. Considering the way the Indian economy is growing, the role of merchant banking services in India is indispensable. These financial institutes also act as corporate advisory bodies to help corporations rightly get involved in various financial activities. Merchant banks serve a dual role within the financial sector. Through deposits or sales of securities they obtain funds for lending to their clients (SEBI) forbids lending by them): a function similar to most institutions. Their other role is to act as agents in return for fee. SEBI envisages a mandatory role for merchant banks in exercising due diligence apart from issue management, in buy-backs and public offer in takeover bids. Their underwriting and corporate financial services are all fees rather than fund based and their significance is not reflected in their total assets of the industry. SEBI has been pressing for merchant banks to be primarily fee based institutions. According to the Ministry of Finance in India, a merchant banker is a person or body engaged in selling, buying and subscribing to securities or in advising the corporations on issue management. To learn

more about the merchant banking setup in India, you should go through the following discussion.

♣ **History of Indian Merchant Banking** The formal beginning of the merchant banking services in India began in 1967 when the Reserve Bank of India provided license to the Grindlays Bank. The Grindlays Bank was engaged in capital issue management and it provided diverse financial services to the emerging section of entrepreneurs, especially those belonging to the small and medium enterprise sector. Citibank started the merchant banking services in 1970 and the State Bank of India followed the same in 1972. After few years, the national merchant banks started collaborating with their counterparts in different countries to start their merchant banking divisions abroad. After that there were many banks which set up the merchant bank division such as; • ICICI • Bank of India • Bank of Baroda • Canara Bank • Punjab National Bank • UCO Bank The Merchant Bank got more importance in the year 1983 when there was a huge boom in the primary market where the companies were going for new issue. Merchant banking activities are organized and undertaken in several forms. Commercial banks and foreign development finance institutions have organized them through formation divisions, nationalized banks have formed subsidiary companies, share brokers and consultancies constituted themselves into public limited companies or registered themselves as private limited Companies. Some merchant banking companies have entered into collaboration with merchant bankers of foreign countries abroad with several branches.

♣ **Organizational Setup / Types of Merchant Banking Organization in India** In India a common organizational set up of merchant bankers to operate is in the form of divisions of Indian and Foreign banks and Financial institutions, subsidiary companies established by bankers like SBI, Canada Bank, Punjab National Bank, Bank of India, etc. some firms are also organized by financial and technical consultants and professionals. Securities and exchanges Board of India (SEBI) has divided the merchant bankers into four categories based on their capital adequacy. Each category is authorized to perform certain functions. From the point of Organizational set up India‟s merchant banking organizations can be categorized into 4 groups on the basis of their linkage with parent activity. They are: a) Institutional Base:-Where merchant banks function as an independent wing or as subsidiary of various Private/ Central Governments/State Governments Financial institutions. Most of the financial institutions in India are in public sector and therefore such set up plays a role on the lines of governmental priorities and policies. b) Banker Base:-These merchant bankers function as division/ subsidiary of banking organization. The parent banks are either nationalized commercial banks or the foreign banks operating in India. These organizations have brought professionalism in merchant banking sector and they help their parent organization to make a presence in capital market. c) Broker Base:-In the recent past there has been an inflow of Qualified and professionally skilled brokers in various Stock Exchanges of India. These brokers undertake merchant baking related operating also like providing investment and portfolio management services. d) Private Base:-These merchant banking firms are originated in private sectors. These organizations are the outcome of opportunities and scope in merchant banking business and they are providing skill oriented specialized services to their clients. Some foreign merchant bankers are also entering either independently or through some collaboration with their Indian counterparts. Private Sectors merchant banking firms have come up either as sole proprietorship, partnership, private limited or public limited companies. Many of these firms were in existence for quite some time before they added a new activity in the form of merchant banking services by opening new division on the lines of commercial banks and All India Financial Institution (AIFI). Classification Merchant Banking in India Merchant Banking Divisions Financial Institutions Indian Banks Subsidiary Division in Bank Foreign Banks Private Merchant Bank

♣ **Merchant Bankers in India** As of now there are 135 Merchant bankers who are registered with SEBI in India. It includes Public Sector, Private Sector and foreign players some of them are:- Public Sector Merchant Bankers:- · SBI capital markets ltd · Punjab National bank · Bank of Maharashtra · IFCI financial services ltd · Karur Vysya bank ltd, · State Bank of Bikaner and Jaipur Private Sector Merchant Bankers:- · ICICI Securities Ltd · Axis Bank Ltd (Formerly UTI Bank Ltd.) · Bajaj Capital Ltd · Tata Capital Markets Ltd · ICICI Bank Ltd · Reliance Securities Limited · Kotak Mahindra Capital Company Ltd · Yes Bank Ltd. Foreign Players in Merchant Banking:- · Goldman Sachs (India) Securities Pvt. Ltd. · Morgan Stanley India Company Pvt. Ltd · Barclays Securities (India) Pvt. Ltd · Bank Of America, N.A · Deutsche Bank · Deutsche Equities India Private Limited · Barclays Bank Plc · Citigroup Global Markets India Pvt. Ltd. · DSP Merrill Lynch Ltd · FEDEX Securities Ltd.

♣ **Organization of Merchant Banking Units** The structure of organization of Merchant banks reveals certain similar characteristics:-

- A high proportion of professional to total staff;
- A substantial delegation of decision making;
- A short chain of command;

• Rapid decision making;

• Flexible organisation structure;

• Innovative approaches to problem solving; and

• High level of financial sophistication.

In the words of Skully, a merchant bank could be best defined as a financial institution conducting money market activities and lending, underwriting and financial advice, and investment services whose organization is characterised by a high proportion of professional staff able to approach problems in an innovative manner and to make and implement decisions rapidly. Merchant banking activities are regulated by the following:- (1) Guidelines of SEBI and Ministry of Finance, (2) Companies Act, 1956 and (3) Listing Guidelines of Stock Exchange and (4) Securities contracts (Regulation) Act, 1956.

♣ **Functions of Merchant Banking Organizations**

• Distribution of securities like equity shares, mutual funds, insurance products and so on.

• Providing assistance to the enterprises to raise funds from the market.

• Loan syndication for the clients is another important function performed by these organizations.

• Corporate advisory and project advisory services are other important merchant banking services offered by these organizations.

♣ **Importance of Merchant Banking in India** The need of merchant banking services in India arises from the fact that high level industrialization is taking place in the country. So, there is need for skilled professionals who can take care of various finance-related needs of the advanced industrial sectors. These specialist services are also of great importance for the small and medium sized enterprises to help them operate smoothly. Most of the rural areas still lack industrial advancement and the main reasons for this include lack of funds and information. The merchant banking services help the entrepreneurs to come up with industrial setups in these areas. Besides, the merchant banks help the entrepreneurs to explore the joint venture opportunities in the foreign markets. The above discussion highlights the ways merchant banks are promoting industrial development in India. The government in the country plays a significant role by issuing rules and regulations for merchant banks so that entrepreneurs can make most out of these services.

♣ **Importance and need of Merchant Banking in India** Important reasons for the growth of merchant banks has been development activities throughout the country, exerting excess demand on the sources of fund for ever expanding industries and trade, thus leaving a widening gap unabridged between the supply and demand of invisible funds. All financial institutions had experienced constrain of resources to meet ever increasing demands for demands for funds frame corporate sector enterprises. In such circumstances corporate sector had the only alternative to avail of the capital market service for meeting their long term financial requirement through capital issue of equity shares and debentures. Growing demand for funds put pressure on capital market that enthused commercial banks, share brokers and financial consultancy firms to enter into the field of merchant banking and share the growing capital market. As a result all the commercial banks in nationalized and public sector as well as in private sector including foreign banks in India have opened their merchant banking windows and competing in this field. Need for merchant banking is felt in the wake of huge public saving lying untapped. Merchant banker can play highly significant role in mobilizing funds of savers to invisible channels assuring promising returns on investment and thus can assist in meeting the widening demand for invisible funds for economic activity. With growth of merchant banking profession corporate enterprises in both private sectors would be able to raise required amount of funds annually from the capital market to meet the growing requirement for funds for establishing new enterprises, undertaking expansion, modernization and diversification of the existing enterprises. This reinforces the need for a vigorous role to be played by merchant banking. In view of multitude of enactment, rules and regulation, gridlines and offshoot press release instructions brought out the government from time to time imposing statutory obligations upon the corporate sector to comply with those entire requirement prescribed there in the need of a skilled agency existed which could provide counselling in these matters in a package form. A merchant banker with their skills updated information and knowledge provide this service to the corporate units and advise them on such requirement to be complied with for raising funds from the capital market under different enactment viz. companies act, income tax act, foreign exchange regulation act, securities contracts corporate laws and regulations. Merchant bank advice the investors of the incentives available in the form of tax relief, other statutory relaxation, good return on investment and capital appreciation in such investment to motivate them to invest their savings securities of the corporate sector. Thus merchant banks help industries and trade to rise and the investors to invest their saved money in sound and healthy concern with confidence, safety and expectation for higher yields. Finance is the backbone of business activities. Merchant banker make available finance for business enterprises acting as intermediaries between them raising demand for funds and the supplies of funds besides rendering various other services. The following are some of the reasons why specialist merchant bank have a crucial role to play in India

. • Growing complexity in rules and procedures of the government.

• Growing industrialization and increase of technologically advanced industries.

• Need for encouragement of small and medium industrialists, who require specialist services.

• Need to develop backward areas and states which require different criteria.

• Exploring the possibility of joint ventures abroad and foreign market. • Promoting the role of new issue market in mobilizing saving from. Where merchant banks function as an independent wing or as subsidiary of various private/central governments/ state government financial institution. Most of the financial institution in India is in public sector and therefore such setup plays a role on the lines of governmental priorities and policies

. ♣ Difference between Merchant Bank and Commercial Bank

♣ Commercial banks are catering to the needs of the common man whereas the merchant banks cater to the needs of corporate firms

. ♣ Any person can open a bank account in the commercial bank whereas it cannot be done in the merchant bank.

♣ Merchant bank deals with equities whereas the commercial bank deals with debt related finance which includes the activities like credit proposals, loan sanctions etc

. ♣ The merchant bank is exposed to the market so it is more exposed to risk as compared to commercial banks.

♣ Merchant bank is related to the primary market whereas the commercial markets are more into secondary markets.

♣ Merchant banking activities are capital restructuring, underwriting, portfolio management etc. whereas the commercial banks play the role of financers.

♣ The activities of merchant banks have a direct impact on the growth and liquidity of money markets.

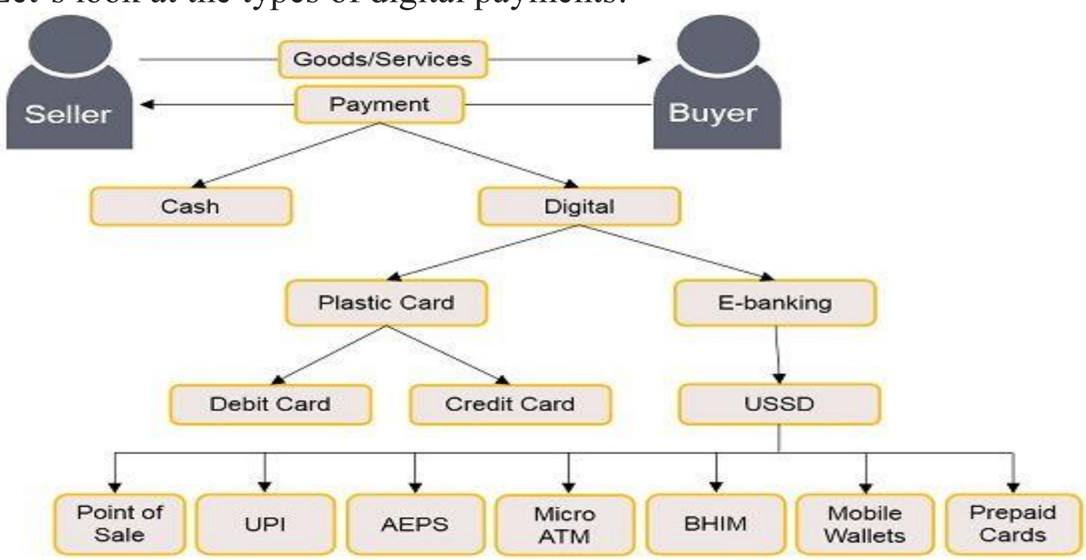
♣ Merchant Bank is management oriented whereas the commercial banks are asset oriented

♣ The commercial banks generally avoid risks and on the other hand the merchant banks are willing to take the risks.

E-banking

Definition: E-banking is a blanket term used to indicate a process through which a customer is allowed to carry out, personal or commercial banking transactions using electronic and telecommunication network. It is a product offered by banks which facilitates online banking, with the help of which the customer can have access to the bank account in just one click. E-banking covers facilities such as – fund transfer, checking account statements, utility bill payments, opening of bank account, locating nearest ATM, obtain information on financial products and services, applying for loans, etc. using a personal computer, smartphone, laptop or personal digital assistant.

Let's look at the types of digital payments:



E-banking Services

In simple words, e-banking refers to a banking arrangement, with which the customer can perform various transactions over the internet, which is end-to-end encrypted, i.e. it is completely safe and secure. E-banking promotes paperless/cashless transactions. It comes with a number of rights, responsibilities and fees as well. The range of services covered under E-banking are:

1. **Internet Banking**: A banking facility provided to the customers through which the customers are able to perform a number of monetary and non-monetary transactions, using the internet, through the bank's website or application.
2. **Mobile Banking**: Almost all the banks have designed their mobile applications with which you can perform transactions at your fingertips. For this, four things are required – a smartphone, internet, mobile application, and mobile banking service enabled in your bank account.
3. **ATM**: Automated Teller Machine, popularly known as ATM is one of the most common and initial service, provided under e-banking. It is not just a machine with which you can withdraw cash as and when required, but it also allows you to check your account status, transfer fund, deposit fund, changes mobile number, change Debit Card PIN, i.e. Personal Identification Number.
4. **Debit Card**: Debit cards are used in our day to day life so as to perform end number of transactions. Debit cards are linked to the customer's bank account and so the customer only needs to swipe the card, in order to make payment at Point of Sale (POS) outlets, online shopping, ATM withdrawal. In this way, the amount is deducted from the customer's account directly.
5. **Credit Card**: Just like a debit card, a credit card is also a payment card which the banks issue to the customers on their request, after checking their credit score and history. It enables the cardholder to borrow funds upto the pre-approved limit and make payment. The limit is granted by the banks which issue the card. The cardholder promises to repay the amount within a stipulated time, with some charges, for the use of credit card.
6. **Point of Sale (POS)**: Points of sale system refers to the point, in terms of date, time and place (retail outlet) where the customer makes a payment, using a plastic card, for the purchase made or services received.
7. **Electronic Data Interchange (EDI)**: EDI is a new mode of communicating information between businesses electronically using a standardized format, which was conventionally paper-based.
8. **Electronic Fund Transfer (EFT)**: When money is transferred electronically from one bank to another, it is called as electronic fund transfer. It covers direct debit, direct deposits, wire transfers, NEFT, RTGS, IMPS, etc.

Benefits of E-banking

- It enables digital payments, which encourages transparency.
- It allows 24/7 access to the bank account.
- It also sends notifications and alerts to get updated with the banking transactions and changes in the rules.

- It lowers transaction cost for the banks.
- It is convenient and easy for customers, as they are not required to visit the bank branch every time.

In a nutshell, any type of banking transaction performed through electronic mode comes under E-banking. It is a secure, fast and convenient electronic banking facility that allows its customers to undertake online banking services anytime during the day and at any place using the internet, for which the customers used to visit the banks in earlier days.

Debit card

A bank-issued card that allows its user to access their funds for the purpose of paying for merchandise. A debit card acts like a credit card, the difference being that funds are immediately taken from the cardholders accounts.

Credit card

Pre-approved credit which can be used for the purchase of items now and payment of them later.

Classification of Credit card

Based on mode of credit recovery

• Charge Card-A card that charges no interest but requires the user to pay his/her balance in full upon receipt of the statement, usually on a monthly basis. While it is similar to a credit card, the major benefit offered by a charge card is that it has much higher, often unlimited, spending limits.

• Revolving credit card-A line of credit where the customer pays a commitment fee and is then allowed to use the funds when they are needed. It is usually used for operating purposes, fluctuating each month depending on the customer's current cash flow needs

Based on status of credit card

• Standard Card- it is a generally issued credit card

• Business Card- (Executive cards) it is issued to small partnership firms, solicitors, taxconsultants, for use by executives on their business trips.

• Gold Card-a credit card issued by credit-card companies to favoured clients, entitling them to high unsecured overdrafts, some insurance cover, etc

Based on geographical validity

• Domestic card- Cards that are valid only in India and Nepal are called domestic cards.

• International Card- credit Cards that are valid internationally are called international cards.

Based on franchise/ Tie-up

• Proprietary card- A bank issues such cards under its own brands. E.g. SBI card Cancard of Canara bank

• Master Card- this card is issued under the umbrella of "MasterCard International"
• VISA Card – it is issued by any bank having tie up with "VISA international"
• Domestic Tie-up Card- it is issued by any bank having tie up with domestic credit card brands such as CanCard and IndCard.

Based on issuer Category
• Individual Cards- Non-corporate cards that are issued to individuals
• Corporate Cards- Issued to corporate and business firms.

Smart card

The smart card looks exactly like any other plastic card or an ATM card with an integrated circuit (IC Chip) installed. The IC chip contains memory, may contain a processor, and communicates with the external world through contacts on the surface of the card. The size, position and utility of the contacts are specified by an international standard, so that cards can interact with a variety of equipment.

Banking Ombudsman Scheme

CHAPTER I

PRELIMINARY

1. SHORT TITLE, COMMENCEMENT, EXTENT AND APPLICATION

(1) This Scheme may be called the Ombudsman Scheme for Digital Transactions, 2019.

(2) It shall come into force on such date as the Reserve Bank may specify.

(3) It shall extend to the whole of India.

(4) The Scheme shall apply to the business in India of System Participants as defined under the Scheme.

2. SUSPENSION OF THE SCHEME

(1) The Reserve Bank, if it is satisfied that it is expedient so to do, may by order suspend for such period as may be specified in the order, the operation of all or any of the provisions of the Scheme, either generally or in relation to any specified System Participant.

(2) The Reserve Bank may, by order, extend from time to time, the period of any suspension ordered as aforesaid by such period, as it thinks fit.

3. DEFINITIONS In this Scheme unless there is anything repugnant in the subject or content:

(1) ‘Appellate Authority’ means the Deputy Governor in charge of the Department of the Reserve Bank implementing the Scheme.

(2) ‘Authorised Representative’ means a person (other than an advocate) duly appointed and authorised by a complainant to act on his / her behalf and represent him / her in the proceedings under the Scheme before the 1 System Participant: As defined under Clause 3 (11) of the Scheme. 4 Ombudsman as well as Appellate Authority for consideration of his / her complaint.

(3) 'Award’ means an Award passed by the Ombudsman for Digital Transactions in accordance with the provisions of the Scheme.

(4) ‘Complaint’ means any representation in writing or through electronic means containing grievance/s alleging deficiency in service by the System Participants as mentioned in Clause 8 of the Scheme.

(5) “Digital Transaction’ means a payment transaction in a seamless system effected without the need for cash at least in one of the two legs, if not in both. This includes transactions made through digital / electronic modes wherein both the originator and the beneficiary use digital / electronic medium to send or receive money.”

(6) ‘Ombudsman for Digital Transactions’ means any officer of the Reserve Bank appointed under Clause 4 of the Scheme.

(7) ‘Reserve Bank’ means the Reserve Bank of India constituted under Section 3 of the Reserve Bank of India Act, 1934 (Act 2 of 1934).

(8) ‘Scheme’ means the Ombudsman Scheme for Digital Transactions, 2019.

(9) ‘Secretariat’ means the office constituted as per Sub-Clause (1) of Clause 6 of the Scheme.

(10) ‘Settlement’ means an agreement reached by the parties either by conciliation or mediation under Clause 11 of the Scheme.

(11) ‘System Participant’ means any person other than a bank participating in a payment system as defined under Section 2 of the Payment and Settlement Systems Act, 2007 excluding a ‘System Provider2 ’

(12) All other expressions unless defined herein shall have the same meaning as has been assigned to them under the Payment and Settlement Systems Act, 2007 or any statutory modification or enactment thereto or as used in commercial parlance, as the case may be. 2 ‘System Provider’ means and includes a person who operates an authorised payment system as defined under Section 2 of the Payment and Settlement Systems Act, 2007.

CHAPTER II .

ESTABLISHMENT OF OFFICE OF THE OMBUDSMAN FOR DIGITAL TRANSACTIONS

4. APPOINTMENT & TENURE

(1) The Reserve Bank may appoint one or more of its officers in the rank of Chief General Manager or General Manager to be known as Ombudsman for Digital Transactions to carry out the functions entrusted to them by or under the Scheme.

(2) The appointment of Ombudsman for Digital Transactions under the above Clause may be made for a period not exceeding three years at a time.

5. LOCATION OF OFFICE AND TEMPORARY HEADQUARTERS

(1) The office of the Ombudsman for Digital Transactions shall be located at such places as may be specified by the Reserve Bank.

(2) In order to expedite disposal of complaints, the Ombudsman for Digital Transactions may hold sittings at such places within his/her area of jurisdiction as may be considered necessary and proper by him/her in respect of a complaint or reference before him/her.

6. SECRETARIAT

(1) The Reserve Bank shall depute such number of its officers or other staff to the office of the Ombudsman for Digital Transactions as is considered necessary to function as the secretariat of the Ombudsman for Digital Transactions.

(2) The cost of the Secretariat shall be borne by the Reserve Bank.

(3) The Department administering the Scheme shall act as and discharge the functions of Secretariat of the Appellate Authority.

CHAPTER III

7. JURISDICTION, POWERS AND DUTIES OF THE OMBUDSMAN FOR DIGITAL TRANSACTIONS

(1) The Reserve Bank shall specify the territorial limits to which the authority of each Ombudsman for Digital Transactions appointed under Clause 4 of the Scheme shall extend.

(2) The Ombudsman for Digital Transactions shall receive and consider complaints relating to deficiency in services on the grounds mentioned in Clause 8 irrespective of the pecuniary value. He / She shall, to the satisfaction of the parties involved, dispose of the complaint through: (i) Settlement by agreement between parties; OR (ii) Conciliation and mediation between parties; OR (iii) Passing an Award as per the provisions of the Scheme.

(3) The Ombudsman for Digital Transactions shall exercise general powers of superintendence and control over his/her office and shall be responsible for the conduct of business thereat.

(4) The Office of the Ombudsman for Digital Transactions shall draw up an annual budget in consultation with the Reserve Bank and shall exercise powers of expenditure within the approved budget on the lines of the Expenditure Rules framed by the Reserve Bank from time to time.

(5) The Ombudsman for Digital Transactions shall send to the Governor, Reserve Bank, a report, as on 30th June every year, containing a general review of the activities of his office during the preceding financial year and shall furnish such other information as the Reserve Bank may direct and the Reserve Bank may, if it considers necessary in the public interest so to do, publish the report and the information received from the Ombudsman for Digital Transactions in such consolidated form or otherwise as it deems fit.

CHAPTER IV

PROCEDURE FOR REDRESSAL OF GRIEVANCE

8. GROUNDS OF COMPLAINT Any person may file a complaint free of cost with the Ombudsman for Digital Transactions having jurisdiction on any one of the following grounds alleging deficiency in service:

(1) **Prepaid Payment Instruments**: Non-adherence to the instructions of Reserve Bank by System Participants about Prepaid Payment Instruments3 on any of the following: a) Failure in crediting merchant's account within reasonable time;

b) Failure to load funds within reasonable time in wallets / cards;

c) Unauthorized electronic fund transfer;

d) Non-Transfer / Refusal to transfer/ failure to transfer within reasonable time, the balance in the Prepaid Payment Instruments to the holder's 'own' bank account or back to source at the time of closure, expiry of validity period etc., of the Prepaid Payment Instrument;

e) Failure to refund within reasonable time / refusal to refund in case of unsuccessful / returned / rejected / cancelled / transactions;

f) Non-credit / delay in crediting the account of the Prepaid Payment Instrument holder as per the terms and conditions of the promotion offer(s) from time to time, if any;

g) Non-adherence to any other instruction of the Reserve Bank on Prepaid Payment Instruments.

(2) **Mobile / Electronic Fund Transfers**: Non-adherence to the instructions of the Reserve Bank on Mobile / Electronic fund transfers by System Participants on any of the following: a) Failure to effect online payment / fund transfer within reasonable time;

3 **Semi-closed System PPIs**: These PPIs are issued by banks (approved by RBI) and non-banks (authorized by RBI) for purchase of goods and services, including financial services, remittance facilities, etc., at a group of clearly identified merchant locations / establishments which have a specific contract with the issuer (or contract through a payment aggregator / payment gateway) to accept the PPIs as payment instruments. These instruments do not permit cash withdrawal, irrespective of whether they are issued by banks or non-banks.

8 b) Unauthorized electronic fund transfer;

c) Failure to act upon stop-payment instructions within the time frame and under the circumstances notified to the customers within prescribed timeline;

d) Failure to reverse the amount debited from customer account in cases of failed payment transactions within prescribed timeline;

e) Non-adherence to any other instruction of the Reserve Bank on Mobile / Electronic fund transfers.

(3) Non-adherence to instructions of Reserve Bank / respective System Provider to System Participants, on payment transactions through Unified Payments Interface (UPI) / Bharat Bill Payment System (BBPS) / Bharat QR Code / UPI QR Code on the following grounds:

a) Failure in crediting funds to the beneficiaries' account;

b) Failure to return within reasonable time the payment to the originating member in case of failure to credit the funds to the beneficiary's account;

c) Failure to / delay in refund of money back to account in case of transaction failure or declined transactions (i.e. failed transactions);

d) Non-adherence to any other instruction of the Reserve Bank on payment transactions / through Unified Payments Interface (UPI) / Bharat Bill Payment System (BBPS)/ Bharat QR Code / UPI QR Code.

(4) Non-reversal / failure to reverse within reasonable time, funds wrongly transferred to the beneficiary account due to lapse at the end of System Participant.

(5) Any other matter relating to the violation of the directives including on fees / charges, if any, issued by the Reserve Bank in relation to digital transactions.

9. PROCEDURE FOR FILING COMPLAINT

(1) Any person who has a grievance on any one or more of the grounds mentioned in Clause 8 of the Scheme may, himself or through his authorised 4 The System Participant covered under the Scheme shall display clearly in their branches/websites, the fees/charges to be levied for various digital transactions. 9 representative (other than an advocate), make a complaint to the Ombudsman for Digital Transactions within whose jurisdiction the branch or office of the System Participant complained against is located. Provided that a complaint arising out of services with centralized operations, shall be filed before the Ombudsman for Digital Transactions within whose territorial jurisdiction the billing / declared address of the customer is located.

(2) (a) The complaint in writing shall be duly signed by the complainant or his authorized representative and shall be, as far as possible, in the form specified in Annexure 'A' or as near as thereto as circumstances admit, stating clearly: I. The name and the address of the complainant; II. The name and address of the branch or office of the System Participant against which the complaint is made; III. The facts giving rise to the complaint; IV. The nature and extent of the loss caused to the complainant; and V. The relief sought for. (b) The complainant shall file along with the complaint, copies of the documents, if any, which he / she proposes to rely upon. (c) A complaint made through electronic means may be accepted by the Ombudsman for Digital Transactions. (d) The Ombudsman for Digital Transactions may also entertain complaints covered under this Scheme received by Central Government or Reserve Bank and forwarded to the Ombudsman for Digital Transactions for disposal.

(3) No complaint to the Ombudsman for Digital Transactions shall lie unless:

(a) The complainant had, before making a complaint to the Ombudsman for Digital Transactions, (i) made a written representation to the System Participant who had rejected the complaint, or, (ii) the complainant had not received any reply within a period of one month after the System Participant received her/his representation, or, (iii) the complainant is not satisfied with the reply given to her/him by the System Participant;

(b) The complaint is made not later than one year after the complainant has received the reply of the System Participant to her/ his representation or, 10 where no reply is received, not later than one year and one month after the date of the representation to the System Participant;

(c) In exceptional circumstances as decided by the Ombudsman, the complaint is made before the expiry of the period of limitation prescribed under the Indian Limitation Act, 1963 for such claims.

(d) The complaint is not in respect of the same cause of action which was settled or dealt with on merits by the Ombudsman for Digital Transactions in any previous proceedings, whether or not, received from the same complainant or along with one or more complainants or one or more of the parties concerned with the cause of action;

(e) The complaint does not pertain to the same cause of action, for which any proceedings before any court, tribunal or arbitrator or any other forum is pending or a Decree or Award or Order has been passed by any such Court, Tribunal, Arbitrator or Forum;

(f) The complaint is not frivolous or vexatious in nature;

(g) The complaint does not fall under the disputes covered under Section 24 of the Payment and Settlement Systems Act, 2007; and

(h) The complaint does not pertain to disputes arising from a transaction between customers.

10. POWER TO CALL FOR INFORMATION

(1) For the purpose of carrying out his duties under this Scheme, the Ombudsman for Digital Transactions may require the System Participant against whom the complaint is made or any other System Participant concerned with the complaint, to provide any information or furnish certified copies of any document relating to the complaint which is or is alleged to be in its possession. Provided that in the event of the failure of a System Participant to comply with the requisition without sufficient cause, the Ombudsman for Digital Transactions may, if he/ she deems fit, draw the inference that the information, if provided, or copies if furnished, would be unfavourable to the System Participant. 11

(2) The Ombudsman for Digital Transactions shall maintain confidentiality of any information or document that may come into his knowledge or possession in the course of discharging his duties and shall not disclose such information or document to any person except with the consent of the person furnishing such information or document. Provided that, nothing in this Clause shall prevent the Ombudsman for Digital Transactions from disclosing information or document furnished by a party in a complaint to the other party or parties to the extent considered by him to be reasonably required to comply with any legal requirement or the principles of natural justice and fair play in the proceedings.

11. SETTLEMENT OF COMPLAINT BY AGREEMENT

(1)As soon as it may be practicable to do, the Ombudsman for Digital Transactions shall send a copy of the complaint to the branch or office of the System Participant named in the complaint, under advice to the Nodal Officer referred to in Sub-Clause (4) of Clause 15, and endeavour to promote a settlement of the complaint by agreement between the complainant and the System Participant through conciliation or mediation. (2)For the purpose of promoting a settlement of the complaint, the Ombudsman for Digital Transactions shall not be bound by any rules of evidence and may follow such procedure as he may consider just and proper, which shall, however, at the least, require the Ombudsman for Digital Transaction to provide an opportunity to the complainant to furnish his/her submissions in writing along with documentary evidence within a time limit on the written submissions made by the System Participant. Provided, where the Ombudsman for Digital Transactions is of the opinion that the documentary evidence furnished and written submissions by both the parties are not conclusive enough to arrive at a decision, he may call for a meeting of System Participant and the complainant together, to promote an amicable resolution. Provided further that where such meeting is held and it results in a mutually acceptable resolution of the grievance, the proceedings of the meeting shall be 12 documented and signed by the parties specifically stating that they are agreeable to the resolution and thereafter the Ombudsman for Digital Transactions shall pass an order recording the fact of settlement annexing thereto the terms of the settlement.

(3) The Ombudsman for Digital Transactions may deem the complaint as resolved, in any of the following circumstances: a. Where the grievance raised by the complainant has been resolved by the System Participant with the intervention of the Ombudsman for Digital Transactions; or b. The complainant agrees, whether in writing or otherwise, to the manner and extent of resolution of the grievance provided by the Ombudsman for Digital Transactions based on the conciliation and mediation efforts; or c. In the opinion of the Ombudsman for Digital Transactions, the System Participant has adhered to the norms and practices in vogue and the complainant has been informed to this effect through appropriate means and complainant's objections, if any, to the same are not received by the Ombudsman for Digital Transactions within the time frame provided.

(4) The proceedings before the Ombudsman for Digital Transactions shall be summary in nature.

12. AWARD

(1) If a complaint is not settled by agreement within a period of one month from the date of receipt of the complaint or such further period as the Ombudsman for Digital

Transactions may allow the parties, he may, after affording the parties a reasonable opportunity to present their case, pass an Award.

(2) The Ombudsman for Digital Transactions shall consider the evidence placed before him by the parties, the principles of banking law and practice, directions, instructions and guidelines issued by the Reserve Bank from time to time and such other factors which in his opinion are relevant to the complaint.

(3) The Award shall state briefly the reasons for passing the Award. 13

(4) The Award passed under Sub-Clause (1) shall contain the direction/s, if any, to the System Participant for specific performance of its obligations and in addition to or otherwise, the amount, if any, to be paid by the System Participant to the complainant by way of compensation for any loss suffered by the complainant, arising directly out of the act or omission of the System Participant.

(5) Notwithstanding anything contained in Sub-Clause (4), the Ombudsman for Digital Transactions shall not have the power to award compensation which is more than the actual loss suffered, or two million rupees whichever is lower. The compensation that can be awarded by the Ombudsman for Digital Transactions shall be exclusive of the amount involved in the dispute.

(6) The Ombudsman for Digital Transactions may also award compensation in addition to the above but not exceeding rupees 0.1 million to the complainant, taking into account the loss of the complainant's time, expenses incurred by the complainant, harassment and mental agony suffered by the complainant.

(7) A copy of the Award shall be sent to the complainant and the System Participant free of cost.

(8) An Award shall lapse and be of no effect unless the complainant furnishes to the System Participant concerned within a period of 30 days from the date of receipt of copy of the Award, a letter of acceptance of the Award in full and final settlement of his/her claim. Provided that no such acceptance may be furnished by the complainant if he has filed an Appeal under Sub-Clause (1) of Clause 14.

(9) The System Participant shall, unless it has preferred an appeal under SubClause (1) of Clause14, within one month from the date of receipt by it of the acceptance in writing of the Award by the complainant under Sub-Clause (8), comply with the Award and intimate compliance to the Ombudsman for Digital Transactions. (10) It shall be the obligation of the System Participant concerned to implement the settlement arrived with the complainant or the Award passed by the Ombudsman for Digital Transactions when it

becomes final and send a report in this regard to the Reserve Bank within 15 days of the Award 14 becoming final. In the event of non-implementation of settlement or the Award, the complainant may represent to the Reserve Bank and the Reserve Bank may initiate such action under the provisions of applicable Statutes, as it deems fit.

13. REJECTION OF THE COMPLAINT

(1) The Ombudsman for Digital Transactions may reject a complaint at any stage if it appears to him that the complaint made is; a. Not on the grounds of complaint referred to in Clause 8; or b. Not in accordance with Sub Clause (3) of Clause 9; or c. Beyond the limit of compensation prescribed under Clause 12 (5) and 12 (6): or d. Requiring consideration of elaborate documentary and oral evidence and the proceedings before the Ombudsman for Digital Transactions are not appropriate for adjudication of such complaint; or e. Without any sufficient cause; or f. Not pursued by the complainant with reasonable diligence; or g. In the opinion of the Ombudsman for Digital Transactions there is no loss or damage or inconvenience caused to the complainant. (2) The Ombudsman for Digital Transactions, shall, if it appears at any stage of the proceedings that the complaint pertains to the same cause of action, for which any proceedings before any court, tribunal or arbitrator or any other forum is pending or a decree or Award or order has been passed by any such court, tribunal, arbitrator or forum, pass an order rejecting the complaint giving reasons thereof.

14. APPEAL BEFORE THE APPELLATE AUTHORITY

(1) Party to the complaint aggrieved by an Award under Clause 12 or rejection of a complaint for the reasons referred to in Sub Clauses (d) to (g) of Clause 13, may within 30 days of the date of receipt of communication of Award or rejection of complaint, prefer an appeal before the Appellate Authority. 15 Provided that, in case of appeal by the System Participant, the period of thirty days for filing an appeal shall commence from the date on which the System Participant receives letter of acceptance of Award by complainant under SubClause (8) of Clause 12. Provided that the Appellate Authority may, if satisfied that the applicant had sufficient cause for not making the appeal within time, allow a further period not exceeding 30 days. Provided further that appeal may be filed by a System Participant only with the previous sanction of the Chairman or, in his absence, the Managing Director or the Executive Director or the Chief Executive Officer or any other equivalent officer.

(2) The Appellate Authority shall, after giving the parties a reasonable opportunity of being heard: (a) Dismiss the appeal; or, (b) Allow the appeal and set aside the Award; or, (c) Remand the matter to the Ombudsman for Digital Transactions for fresh disposal in accordance with such directions as the Appellate Authority may consider necessary or proper; or, (d) Modify the Award and pass such directions as may be necessary to give effect to the Award so modified; or, (e) Pass any other order as it may deem fit. (3) The order of the Appellate Authority shall have the same effect as the Award passed by the Ombudsman for Digital Transactions under Clause 12 or the order rejecting the complaint under Clause 13, as the case may be.

15. SYSTEM PARTICIPANTS TO DISPLAY SALIENT FEATURES OF THE SCHEME FOR COMMON KNOWLEDGE OF PUBLIC

(1) The System Participant covered under the Scheme shall ensure to display prominently in all its offices and branches the internal customer grievance redressal framework, including contact details of the designated nodal officer to handle the customer complaints / grievances along with the escalation matrix. 16

(2) The System Participant covered under the Scheme shall also ensure that the purpose of the Scheme and the contact details of the Ombudsman for Digital Transactions to whom the complaints are to be made by the aggrieved party are displayed prominently in all the offices and branches of the System Participant in such manner that a person visiting the office or branch has adequate information of the Scheme.

(3) The System Participant covered by the Scheme shall ensure that a copy of the Scheme is available with the designated officer of the System Participant for perusal in the office premises and notice about the availability of the Scheme with such designated officer shall be displayed along with the notice under Sub-Clause (1) & (2) of this Clause. The System Participant shall place a copy of the Scheme on its websites / mobile applications and update the same as and when required.

(4) The System Participant covered by the Scheme shall appoint Nodal Officers at their Regional / Zonal Offices and inform the respective Office of the Ombudsman for Digital Transactions under whose jurisdiction the Regional / Zonal Office falls. The Nodal Officer, so appointed shall be responsible for representing the System Participant and furnishing information to the Ombudsman for Digital Transactions in respect of complaints filed against the System Participant. Wherever more than one zone / region of the System Participant is falling within the jurisdiction of the Ombudsman for Digital

Transactions, one of the Nodal Officers shall be designated as the 'Principal Nodal Officer' for such zones or regions.

CHAPTER V

MISCELLANEOUS

16. REMOVAL OF DIFFICULTIES If any difficulty arises in giving effect to the provisions of this Scheme, the Reserve Bank may make such provisions not inconsistent with the Payment and Settlement Systems Act, 2007 or the Scheme, as it appears to it to be necessary or expedient for removing the difficulty.

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