Chapter 1

Introduction to Banking

Meaning of Bank

Bank is a financial institution which receives deposits from the public and lends loans and advances to those who are in need of funds for various purposes.

Bank is a financial institution licensed to receive deposits and make loans. It receives money from those who want to save in the form of deposits and it lends money to those who need it.

Bank is an establishment authorized by a government to accept deposits, pay interest, clear cheques, make loans, act as an intermediary in financial transactions, and provide other financial services to its customers.

A bank is a financial intermediary that accepts deposits and channels those deposits into lending activities, either directly by loan or indirectly through capital markets.

Definition of Bank

Banking companies Act of India defines bank as "a financial institution which accepts money from public for the purpose of lending or investment repayable on demand or otherwise withdrawal by cheques, drafts or order or otherwise".

Meaning of Banking

Banking is the business activity of accepting and safeguarding money owned by other individuals and entities, and then lending out this money in order to earn a profit.

Definition of Banking

According to section 5(b) of the Banking Regulation Act, 1949, "banking means the accepting for the purpose of lending or investment, of deposits of money from the public, repayable on demand or otherwise, and withdrawal by cheque, draft, order or otherwise".

Features of bank

- **Deals in money:** Bank deals with all the money related transactions. People can deposit money in a bank account to save it securely and to get interest from the money that is saved in the account. It is the easiest way to increase your money without putting it at any risk. Moreover they can borrow the money from the bank at a certain interest whenever needed.
- **Acceptance of deposits:** Accepting deposits from the savers is the primary function of bank. Banks accept deposit from those who can save. People prefer to deposit their savings in a bank because by doing so, they earn interest.
- **Giving advances/Provide loans:** Banks make money by advancing loans to public. Different banks provide different loans at different interest rates. They provide loans for various requirements such as education, home, vehicle etc.
- **Payment and withdrawal facilities:** Bank provides various payment and withdrawal services to customers so that they can receive their money hassle-free. Customers can make payment using cheques, draft, plastic money etc and they can withdraw money using cheques, debit cards and ATM's installed by the banks at different locations in the city.

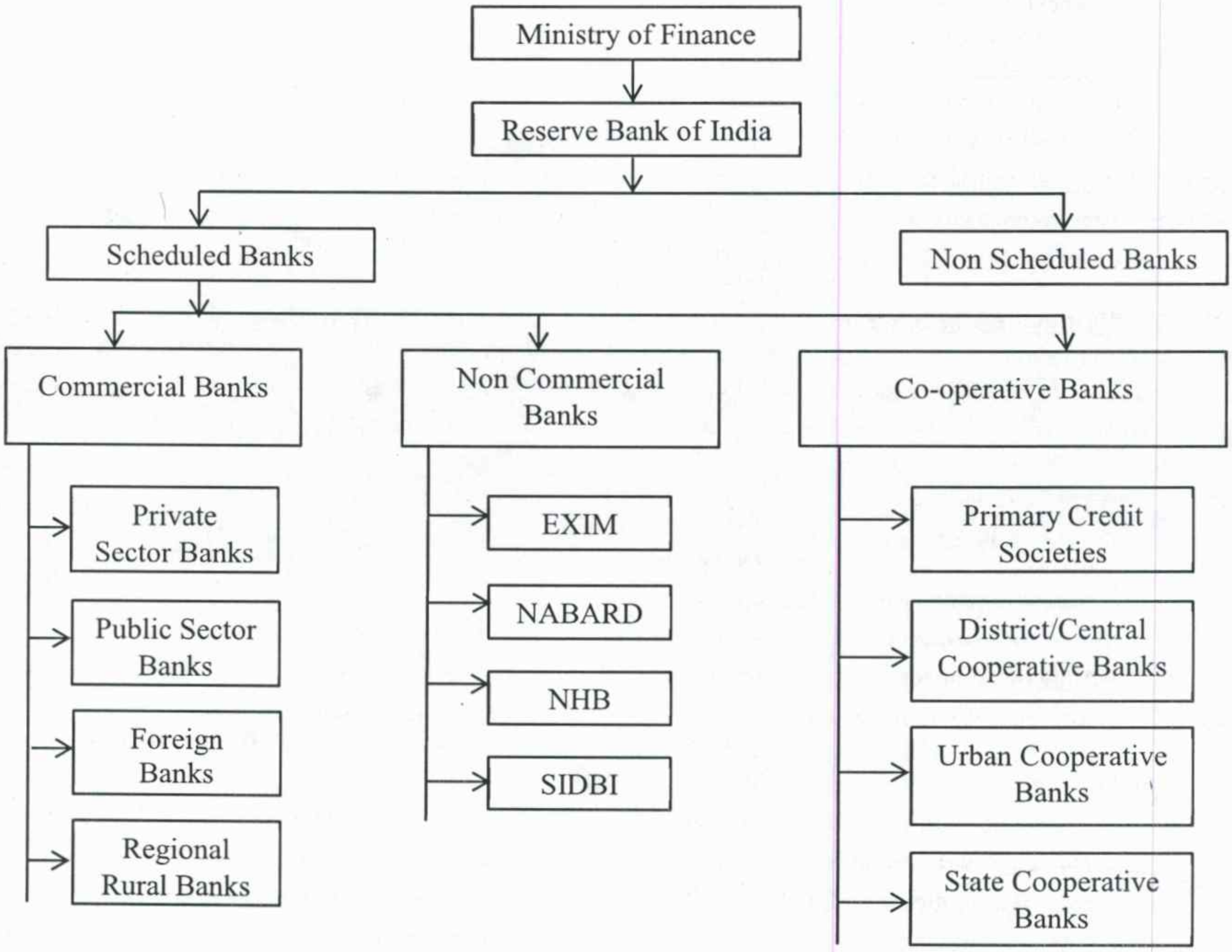
- **Agency and utility services:** Banks other than performing the primary function of collecting and lending money, it also offers agency and general utility services to its customers.
- **Connecting link:** Bank acts as a connecting link between borrowers and lender of money. Banks collect money from those who have surplus money and give the same to those who are in need of money.
- **Commercial in nature:** All the banking functions are carried on with the aim of making profit. So bank is regarded as a commercial institution.
- **Name identity:** Basic services provided by all banks are the same, but each bank tries to provide different interest rates and better services to attract more and more customers. Each bank uses a unique bank name and unique tagline to sell their services. So that people can identify it easily and differentiate with the services of other banks.
- **Branches at different location:** Each bank is opening more and more branches with the increase in the population so that they can satisfy their customers properly by being near to them. People are not required to travel miles like the old times to do banking. Banks are also opening their branches in the rural part of the country to connect people and to gain more profits.
- **Ever increasing functions:** Banking sector is also focused on enhancing their functionality and is one of the fields which are growing fastest. Banks have developed from just providing cash deposit, money lending and withdrawal services to providing loans to cashless bank services to internet and mobile banking.

Role/Need/Importance of Bank

- **Mobilization of savings:** Banks allow savings to be deposited in different types of accounts such as Current Account, Savings Bank Account, Fixed Deposit Account etc carrying different interest rates. This additional income encourages people to save money and put it in the banks.
- **Reduces use of currency:** Banks enable depositors to make payment by cheques, plastic money etc issued by the banks instead of liquid money. Thus, associated problems of use of currency are considerably reduced.
- **Benefits to rural economy:** Rural branches of banks play a useful role in mobilizing savings in rural areas and provide loans to farmers and artisans at concessional rates and on priority basis. This helps the rural economy.
- **Balanced regional development:** Banks identify areas that need special assistance for industrial development and identify backward regions and help in their economic development by providing them adequate funds at reasonable rates.
- **Development of credit policy:** The Central Bank of a country develops a proper monetary policy by determining the bank rate which further affects interest rate and credit policy in the country that ultimately leads to effect on economic development of the country.
- **Facilitates foreign trade:** It also facilitate import export transactions. RBI regulates all the import and export transactions and facilitates bringing foreign exchange to be used for country's economic development.
- **Capital formation:** Deposits accepted by banks are converted into loans and advances for industrial and trading activities to business organisations. This way, banks convert savings into investment leading to capital formation and development of economy.

- **Services to business:** Banking helps business through a variety of services like providing short-term and long-term finance, arranging remittance of money, collection of cheques and bills etc and also helping in raising of the capital by acting as underwriters etc
- **Raising of standard of living:** It helps in raising the standard of living of people by providing loans for purchase of consumer durable goods, houses, automobiles etc.
- **Economic development:** It helps in national development by providing credit to farmers, small scale industries and self-employed people as well as to business houses which leads to balanced economic development in the country.

Structure of banking system in India



The Ministry of Finance is an important ministry within the Government of India concerned with the economy of India, serving as the Indian Treasury.

Reserve Bank of India was established on **1st April 1935 with a share capital of Rs 5 crores** in accordance with the provisions of RBI Act 1934 on the basis of the recommendations of the **Hilton Young Commission**. It was **nationalized on 1st January 1949**. It is entrusted with the responsibility of guiding and regulating the banking system. Banking regulation Act 1949 empowered the RBI to regulate, control and inspect the banks in India and also provided that no new bank or branch of an existing bank could be opened without a license from the RBI.

<u>I. Scheduled Bank:</u> A Scheduled Bank refers to all those banks that are **listed in the II Schedule of RBI Act, 1934**. These carry out the normal business of banking such as accepting deposits, giving out loans and other banking services. The banks included in this category should fulfill two conditions

- ✓ The bank with the **paid up capital of 5 lakh rupees** and this capital must be maintained throughout their operational period.
- ✓ The RBI must be satisfied that the banks affairs are **not conducted** in a manner that is **harmful to the interest of its depositors**.

<u>A. Commercial Banks:</u> **It is a type of financial institution that is authorized by law to provide services such as accepting deposits, making business loans, and offer basic investment products**. It is also called as **Business Bank**. The operations of these banks are regulated by RBI. They cater to the financial requirements of industries and various sectors like agriculture, rural development, etc. **It is a profit-making institution owned by government or private or both**. The commercial banks provide the required financial support and infrastructure for both internal and external trade.

1. <u>**Public Sector Banks:**</u> These are the banks where a **majority stake (i.e., > 51%) is held by a Government**. In India, public sector banks operate under the guidelines of RBI. The shares of these banks are listed on stock exchanges. At present there are **12** Public Sector Banks. **(Largest – SBI and Oldest or First – Allahabad Bank, now merged with Indian Bank)**

Bank of India	Indian Bank
Bank of Baroda	Canara Bank
Bank of Maharashtra	Punjab National Bank
Central Bank of India	Punjab Sind Bank
State Bank of India	United Commercial Bank (UCO)
Union Bank of India	Indian Overseas Bank

2. <u>**Private Sector Banks:**</u> It is a type of commercial banks where **private individuals and businesses own a majority of the share capital**. All private banks are recorded as companies with limited liability. At present there are **21** Private Sector Banks. **(Largest – HDFC Bank and Oldest or First – IndusInd Bank)**
   <u>Examples:</u> Housing Development Finance Corporation (HDFC) Bank, Industrial Credit and Investment Corporation of India (ICICI) Bank, IndusInd Bank, Kotak Mahindra, Axis Bank, Yes Bank etc.

3. <u>**Foreign Banks:**</u> It is a type of commercial banks that are **headquartered in a foreign country, but operate branches in different countries**. In India, since financial reforms of 1991, there is a rapid increase in the number of foreign banks. Commercial banks mark significant importance in the economic development of a country as well as serving the financial requirements of the general public. At present there are **46** Foreign Banks. **(Largest – Standard Chartered Bank and Oldest or First – Grindlays Bank) (HSBC Bank – Setup first ATM in India in the year**

1987 in Mumbai and Barclays Bank - Setup first ATM in the world in the year 1967 in United Kingdom)
Examples: City Bank, HSBC (Hongkong and Shanghai Banking Corporation), Standard Chartered Bank, American Express Bank

4. **Regional Rural Banks:** They have been created with a view of **serving primarily the rural areas of India with basic banking and financial services**. It aims at taking the banking facilities to the doorsteps of rural masses especially in remote areas. The objective was to provide credit to small and marginal farmers, agricultural laborers, artisans and small entrepreneurs so as to develop productive activities in the rural areas. At present there are **43** RRB. **(Largest –Baroda UP Bank and Oldest or First –Prathama Bank) (Uttar Pradesh – Highest number of RRBs and Karnataka – There are 2 RRBs {Karnataka Gramin Bank and Karnataka Vikas Grameena Bank})**
Examples: Kerala Gramin Bank, Pragathi Krishna Gramin Bank, etc.

B. Non – Commercial Banks: A non – commercial bank is similar to a **non-profit organization** as it caters to clients to provide them **traditional banking services**. It provides limited services to clients. The aim of these banks is not earning profit but delivering development opportunities to the people. The primary purpose of it is to provide basic banking services and incentives to emerging entrepreneurs. They generally do not provide internet banking and other facilities to the clients. The only services they provide are accepting deposits, lending small amounts to borrowers along with few others.
Examples: SIDBI, NABARD, EXIM and National Housing Bank

1. **SIDBI (Small Industries Development Bank of India):** SIDBI can provide a **loan for a small scale enterprise or business**. It also finances the modernization of small-scale industrial units, use of new technology and market activities. The aim and focus of SIDBI are to **promote, finance and develop small-scale industries**.

2. **Export and Import Bank (EXIM Bank):** EXIM Bank stands for Export and Import Bank. This type of bank can provide **loans or other financial help to foreign countries that are exporting or importing goods**. If we want to set up a business for exporting products abroad or importing products from foreign countries for sale in our country, EXIM bank can provide the required support and assistance. The bank grants loans to exporters and importers and also provides information about the international market. It gives guidance about the opportunities for export or import, the risks involved in it and the competition to be faced, etc.

3. **NABARD (National Bank for Agricultural and Rural Development):** It is a **central or apex institution for financing agricultural and rural sectors.** If a person is engaged in agriculture or other activities like hand loom weaving, fishing, etc, NABARD can provide credit, both short term and long-term, through regional rural banks. It provides financial assistance, especially, to co-operative credit, in the field of agriculture, small-scale industries, cottage and village industries handicrafts and allied economic activities in rural areas.

4. **National Housing Bank (NHB):** It is the **apex regulatory body for overall regulation and licensing of housing finance companies in India**. NHB regulates the housing finance system of

the country, extends refinance to different primary lenders. Its objective is to operate as a principal agency to promote housing finance institutions both at local and regional levels and to provide financial and other support incidental to such institutions and for matters connected therewith.

C. Co-operative Banks: It is a **financial entity that is owned and operated by its members**, who are also its customers. They are formed by people who belong to the same local or professional community or who share a common interest. It operates on the principle of **"No profit, No loss"**. The main objective of it is **mutual help**. It is government by State Cooperatives Societies Act, Banking regulation Act 1949 And Cooperative Societies Act 1955.

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

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

3. **Urban Cooperative bank:** It refers to primary cooperative banks located in urban and semi-urban areas. They primarily finance entrepreneurs, small businesses, industries, and self-employment in urban areas, as well as home purchases and educational loans.

4. **State Co-operative Banks:** These are the **apex (highest level)** co-operative banks in all the states of the country. They mobilize funds and help in its proper channelization among various sectors. The money reaches the individual borrowers from the state cooperative banks through the central co-operative banks and the primary credit societies. They obtain their funds from share capital, deposits, loans and overdrafts from the RBI and can **lend money to central co-operative banks and primary credit societies and not directly to the borrowers**.

II. Non-Scheduled Bank: Non- Scheduled Banks are those banks which are **not added in the II Schedule of RBI Act 1934**. The banks with a **reserve capital of less than 5 lakh rupees** qualify as non-scheduled banks. It is also called as **'Local Area Banks' (LAB)**. Unlike scheduled banks, they are **not entitled to borrow from the RBI for normal banking purposes, except, in emergency or "abnormal circumstances."** Non-Scheduled Banks are also required to maintain the cash reserve requirement, not with the RBI, but with them. There are **11** Non-Scheduled State Cooperative Banks as described by RBI. They are often denied the benefits enjoyed by scheduled banks. They are also **not eligible to be a member of a clearing house**. As a result, unscheduled banks **cannot facilitate interbank financial transactions and the clearance of cheques**.

Difference between Commercial and Non commercial Bank

Basis of difference	Commercial Banks	Non Commercial Banks
Definition	It caters to the needs of clients and earns profit on the money deposited	It is similar to a non-profit organization as it caters to clients to

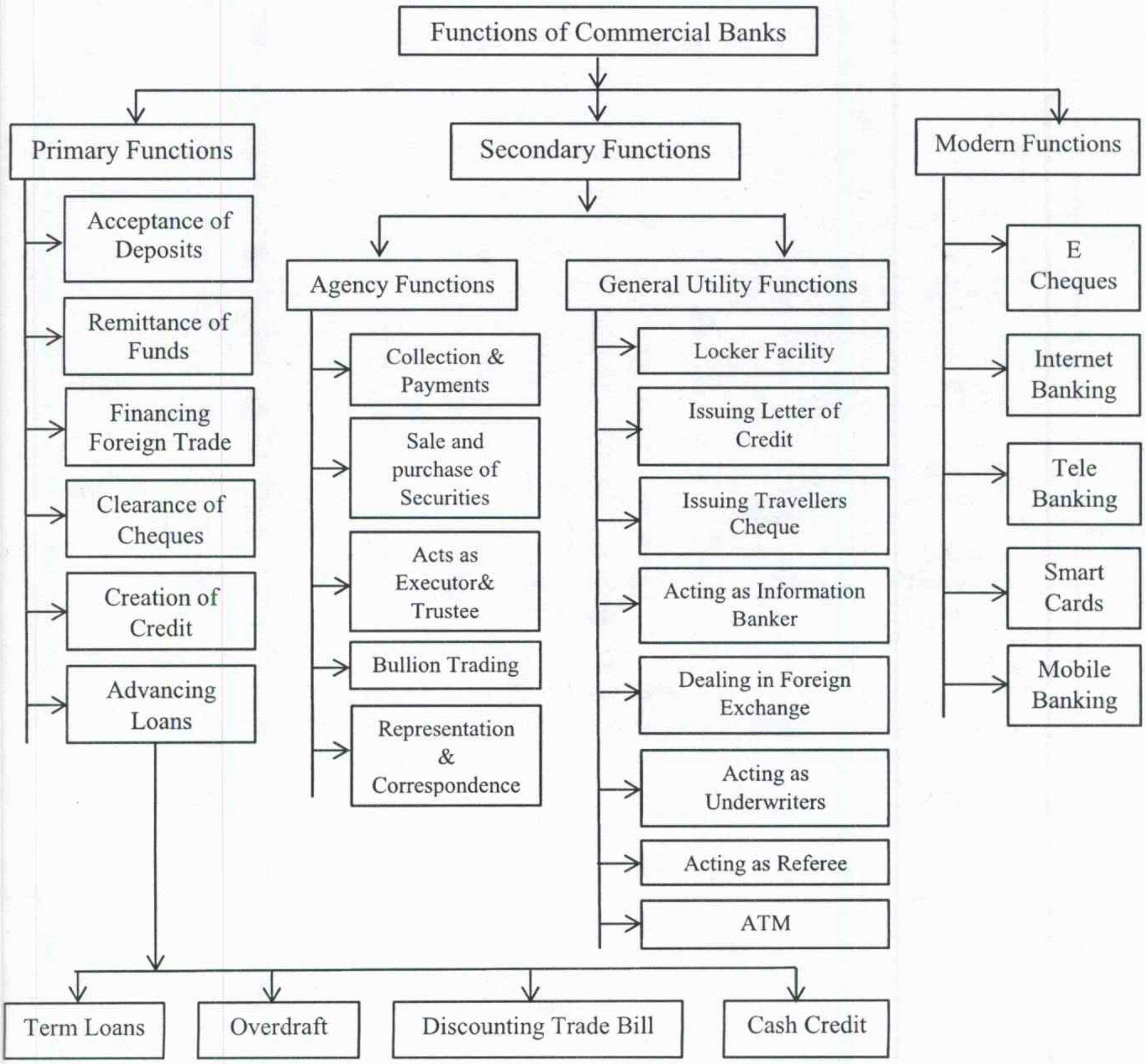
	by lending it to other people.	provide them traditional banking services only.
Banking services offered	It offers a wide range of core banking and other services. These include accepting deposits from clients, dealing with mutual funds and insurance policies, and many others.	It has less to offer in terms of services. Most of these banks only allow money deposition in accounts and small loans.
Principle of operation	The primary purpose of a commercial bank is earning profit through the investment of the client's money in business ventures.	The primary purpose of a non-commercial bank is to provide basic banking services and incentives to emerging entrepreneurs.
Infrastructure	Due to the large profit generation, commercial banks usually have robust infrastructure and facilities for the bankers.	Due to limited profits earned, non-commercial banks have a simple weaker infrastructure.
Security	There are considerable security concerns in commercial banks as they have the freedom to grant loans to any person, irrespective of whether he would be able to return it or not.	They are safe in keeping funds secure as they do not lend large amounts of money to borrowers.
Prevalence	Almost every bank in urban and suburban areas is commercial. People deposit their money in these banks as they see a good chance of earning higher interests.	Non-commercial banks have scarce existence in urban areas. Lower interest rates are the main reason for a decrease in the popularity of these banks.
Scope	They offer many services and facilities to clients.	They have limited scope in providing services.

Difference between Scheduled banks and Non scheduled banks

Basis of difference	Scheduled Banks	Non Scheduled Banks
Meaning	Scheduled Banks are banks whose paid up capital is Rs 5 lakhs and does not harm the interest of the depositors.	Non Scheduled Banks are banks which do not comply with the rules specified by the RBI.
Second schedule	Listed in II schedule of RBI Act 1934.	Not listed in II schedule of RBI Act 1934.
Cash Reserve Ratio (CRR)	CRR is maintained with RBI.	CRR is maintained with themselves.
Borrowing	They are allowed to borrow money from RBI for regular banking purposes.	They are not allowed to borrow money from RBI for regular banking purpose.
Returns	To be submitted periodically.	No such provisions of submitting

		periodic returns.
Member of clearing house	It can become the member of clearing house.	It cannot become the member of clearing house.
Stability	Financially stable compared to Non Scheduled Banks.	Financially instable compared to Scheduled Banks.
RBI rules	They should follow the rules made by the RBI.	They do not follow the rules made by the RBI.
Interest of depositors	They do care about the interest of the depositors.	They don't care about the interests of the depositors because they do not follow the guidelines of RBI.

Functions of Commercial Banks



I. Primary Functions: These are the utmost important functions of commercial banks. It includes

1. **Accepting deposits:** The most important activity of a commercial bank is to mobilize deposits from the public. People who have surplus income and saving deposit the amount with banks for the safety of funds and to earn interest on their deposits. If the rate of interest is higher, public are motivated to deposit more funds with the bank. Commercial banks accept deposits from their customers in the form of saving, fixed, and current deposits.
    - **Savings Deposits:** Savings deposits allow a customer to credit funds towards their account up to a certain limit. These deposits are preferred by individuals with a fixed income.
    - **Fixed Deposits:** Fixed Deposits come with a predetermined lock-in period. They are also referred to as time deposits as the funds are deposited for a specific time frame.
    - **Current Deposits:** Current deposits allow account holders to deposit and withdraw money whenever necessary. The customers will be allowed to overdraw the amount and he will be required to pay interest to the bank on the overdrawn amount.
    - **Recurring Deposit:** It is a unique term deposit that is offered by the banks. It allows the people to make regular deposit that is on monthly basis and earn returns on the investment.

2. **Remittance of funds:** Remittance is derived from the word 'remit' which means 'to send back'. Remittance refers to sending or transferring money to the account of another party. Remittances can be sent via cash, draft, cheque or electronic payment system.

3. **Financing Foreign Trade:** The basic task of financing the foreign trade is similar to that of the home trade i.e., to receive payments from the buyers and to make payments to the sellers. This task is largely performed through the instrument of bills of exchange, which are called foreign bills of exchange. It is concerned with both domestic and international trade transaction.

4. **Clearance of cheques:** The clearing process starts with the deposits of a cheque. These cheques can be either honoured or dishonoured. Cheque clearing or bank clearance is the process of moving cash (or its equivalent) from the bank on which a cheque is drawn to the bank in which it was deposited, usually accompanied by the movement of the cheque to the paying bank, either in the traditional physical paper form or digitally under a cheque truncation system.

5. **Creation of credit:** One of the important functions of commercial banks is credit creation. It is the unique power of Commercial banks to multiply the money. They lend money to individuals and businesses out of deposits accepted from the public. It is a situation in which bank makes more loan to customer and businesses, with the result that the amount of money is circulating. Commercial banks create loans out of deposits and deposits out of loans. This is called as credit creation by commercial banks.

6. **Advancing Loans:** It provides loans and advances to all types of persons particularly to the businessmen and entrepreneurs. Banks make profits by charging interest on these loans or advances.
    - **Term loan:** They are given to acquire or purchase income producing assets such as land, building, plant and machinery, etc. Loan is repaid in installment basis known as EMI.

- **Overdraft:** It means allowing the borrower to over draw his/her current balance and has to pay interest on extra amount withdrawn. The amount has to be repaid within short period. The facilities of overdraft are available for short term to reliable customers only.
- **Discounting trade bills:** It is a process by which the holders of a bill can get the amount mentioned in the bills. Bill discounting can be defined as the advance selling of a bill to an intermediary before it is due to be paid. Banks deducts its charges from the bills.
- **Cash credit:** It is the short-term loan provided to companies to fulfill working capital requirements. It is a proper limit sanctioned by the banks to the borrowing unit against the value of raw materials, semi finished goods and finished goods.

II. Secondary Functions

1. **Agency Functions:** The customers may give standing instructions to the banks to accept and make payments on their behalf. The relationship between banker and customer is that of Principal and Agent.
    - **Collection and payments:** Banks collect cheques, drafts and bills and make payments of rent, insurance premium, telephone bills, installments on hire purchase on behalf of the customers.
    - **Sale and purchase of securities:** Banks purchase and sell various securities like shares, bonds, debentures on behalf of the customers.
    - **Bullion trading:** Bankers trade in bullions trade gold and silver in many countries. Commercial bank like SBI is a nominated bank authorised by RBI to import into India for sale to customers.
    - **Representation and correspondence:** Banks acts as representative of their customers. They get passport, traveler's tickets etc.

2. **General Utility Functions**
    - **Locker service:** Bankers provide lockers facilities to their customers. People can keep their gold or silver or other important documents in these lockers at a very nominal rent. In this way bank accepts the valuable articles and documents for safe custody. In order to rent a safe deposit vault, the customer must first have a savings account with the particular bank.
    - **Issuing letter of credit:** Letter of credit is always issued by the bank. It will be issued only when the bank id assured that purchaser will able to make the payment. It is a popular document in foreign trade. By issuing letter of credit banker certifies the credit worthiness of the customer.
    - **Acting as information banker:** Bankers also act as information bureau as they collect the financial, economic and statistical data relating to industry, trade and commerce. The information is made available to various interested parties.
    - **Dealing in foreign exchange:** Banks exchange domestic currencies for the foreign currencies and vice versa. Commercial banks are the main authorised dealers of foreign exchange in India.

- **Acting as underwriters:** Commercial banks underwrites it's securities, that is the banks take responsibility for selling a part or other securities bought by their customers. In lieu of this work, they take the underwriting charges and commission from the customers.
- **Acting as a referee:** Banker also acts as a referee. Banks give information about the economic position of their customers to domestic and foreign traders. The bank will act as referee only if it is desired by the customers otherwise the secrecy of the customer's account is maintained very carefully.
- **ATM (Automated Teller Machine):** It allows the customers to access the cash at the point of purchase rather than carrying cash and it reduces the danger theft. It gives convenience to access the money when and where ever wanted.

III. Modern Functions

1. **E-cheques:** E-cheque is a cheque in an electronic format where the payment is made through internet or other data network. It is designed to perform the same functions as a conventional paper cheque.

2. **Internet Banking:** It is also known as modern or online banking. It is an electronic payment system that enables customers of a bank or other financial institutions to conduct a range of transactions through the institutions websites. It is a method of banking in which transactions are conducted electronically via internet.

3. **Tele banking:** It is a service provided by the bank or any financial institutions that enables customers to perform over telephone which do not involve cash or documents.

4. **Smart Cards:** It is the form of plastic money used by the customers to make payment for their purchases. Paying with cards customers can avoid the long waiting queues in banks, danger of theft, losing money from fraud etc.

5. **Mobile Banking:** Mobile banking is the act of making financial transactions on a mobile device that is through cell phone, tablet, etc. Customers can use smart phone or other cellular device to perform online banking tasks such as transferring funds, bill payments, monitoring the account balance and others.

Customer: Customer is a person one who has any kind of account with the bank. Here person include any human being and artificial person like company, firm etc.

Banker: A person doing the banking business of accepting and safeguarding money owned by other individuals and entities, and then lending out this money for the needy person.

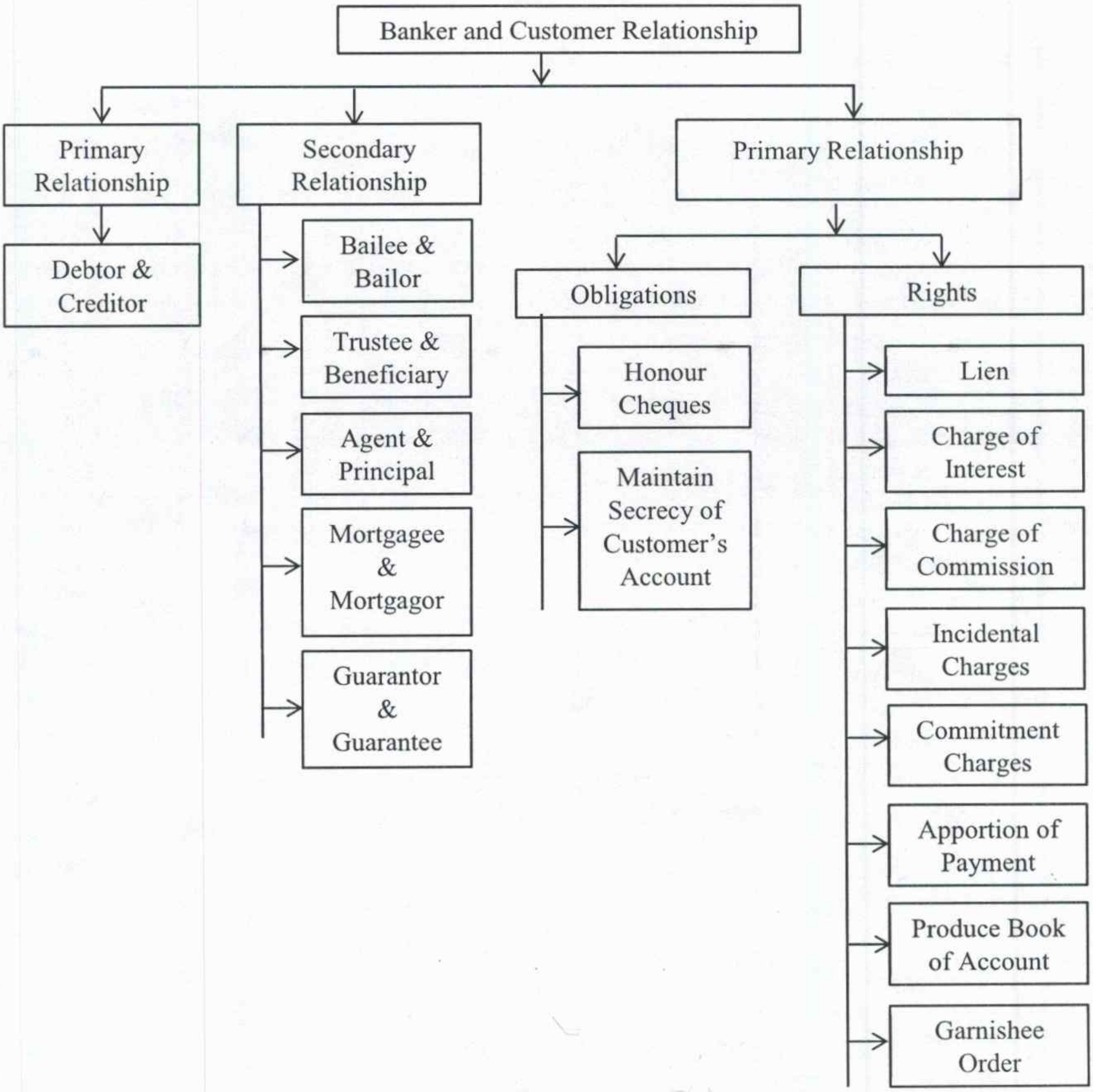
Banker and Customer Relationship

I. Primary Relationship

1. Debtor and Creditor relationship: Debtor and Creditor relationship is a general relationship between banker and customer.

- **When customer opens any kind of account by depositing money:** Bank owes money to the customer and customer has right to receive the money by demand. Here **bank will be a debtor and customer will be a creditor**.

- **When bank grants any loans to its customer:** Bank who grants its money to others and possess the right to recollect money in future date and on the other side customer has to repay the money to bank. Here **bank acts as creditor and customer acts as debtor**. The debtor and creditor relationship remains between two parties until customer repay the full loan amount.



Bank is considered as privileged debtor because of following reason

- **Banker is dignified debtor:** Banker borrows money from customer through various schemes and while borrowing money customer goes to banker and deposit money with banker, but banker never goes and ask customer to lend and moreover customer will have full confidence on banker. Hence banker is termed as dignified debtor.

- **Repayment of amount on demand:** Banker can utilize borrowed amount for further investment purpose and banker can retain the amount with bank until customer demands for the amount.

- **Customer is unsecured creditor:** When customer lends money to bank, his amount will not be covered by any security or property of the bank so he will be considered as unsecured creditor. The customer lend money to bank on the base of confidence.

- **Demand must be in right place:** Customer fund should be repayable on demand and the demand must be made in right place, here banker has no need to pay amount to customer in any other place except bank location. Here customer has to demand his amount in bank premises and in particular branch only. Bank is not like any other debtor, it enjoys the privilege of location.

- **Demand must be made in right time:** Bank enjoys the privilege of time, here creditor i.e. customer must demand bank to repay his amount in particular time i.e. only in working hours of the bank and not other than working hours. The bank must honor the demand if it is made in working hour otherwise bank can reject his demand and no need to pay amount and ask customer to demand in working hour, so customer can take back his amount during specified time.

II. Secondary Relationship

1. Bailee and Bailor Relationship: Bailor is a person who give up the possession of the goods to another person (bailee) under bailment agreement. Bailee is a person who possess the goods which belongs to others called bailor. Here bailee gain only the possession of goods but not the ownership. The actual ownership lies with the bailor only and bailee has no right to use it.
When customer takes safe locker facility of gold jewellery or any other ornament with bank, bailee and bailor relationship lies between banker and customer. Here **banker becomes bailee** and get the possession of customer ornament and not the ownership. Here bank should safeguard the customer belongings but should not use it. Bank has right to charge certain fee for this service. This relationship ends when customer gets back the possession of his goods.

2. Trustee and Beneficiary Relationship: Trustee is a person who administrates the assets or fund for the benefit of third party. Beneficiary is a person who receives benefits from trustee as per the instruction provided by the customer.
For example if a person (customer) deposits a certain sum of money and provides standard instruction to banker regarding usage of the money for some specific purpose say for his son's educational purpose. Hence here bank should use the deposited fund only for his son's educational purpose and not for any other purpose. Here **son becomes beneficiary and bank becomes trustee**. Bank should function as per the standard instruction of the customer.

3. Agent and Principal Relationship: The bank provides various agency functions to its customer. It collects cheques, dividends, bills on behalf of customer. It makes payment of electricity bill, insurance premium, tax, telephone bills on behalf of its customer. It sells and purchases securities on behalf of customer. During these circumstances, agent and principal relationship forms between the banker and customer. **Banker acts as agent** and functions for its client and **customer becomes principal** and instructs banks to act in a particular manner.

4. Mortgagee and Mortgagor Relationship: The relationship between banker and customer may be mortgagee (pledgee) and mortgagor (pledger) when customers pledge any valuable assets as security to take loan. Under such circumstances mortgagee and mortgagor relationship builds between banker and customer. Here **banker acts as mortgagee and customer acts as mortgagor** and customer can gets back the asset after clearing debt, if he fails to clear loan, as per loan agreement banker can acquire the asset which is kept as security.

5. Guarantor and Guarantee Relationship: At the time of international trade importer needs guarantee to receive goods from the exporter. Here bank gives guarantee to its customer i.e. bank issue **"letter of credit"** to exporter by stating strength of importer financial position so that it strengthen the customer international trade. Here **bank acts as guarantor**.

III. Special Relationship: When customer opens any account with the bank, both customer and banker get some rights and obligations. These rights and obligations are reciprocal i.e. customers rights are bankers duties and bankers rights are customer duties. These mutual rights and obligations are called special relationship between banker and customers.

1. Obligations

a. Statutory obligation to honour customer cheque: The banker has to oblige the cheque presented by the customer for payment without fail. If there is sufficient balance in customer account, the banker should not reject the cheque except in few situations. Banker should not damage the credit worthiness of the customer, if bank dishonor any cheque with purely negligence of banker then it has to compensate to customer for damages or loss caused by the banker.

The banker must honour the customer cheque in the following situation

- **When there is credit balance with customer account:** When there is credit balance with customer account the banker should honour the cheque without fail except in few circumstances. The amount mentioned in the cheque is equal or less than credit balance of account then bank must oblige the cheque. If the customer have current account under overdraft facility then the banker should consider the cheque amount and maximum limit of overdraft facility.

- **Correctness of cheque:** In order to honour cheque required information have to be filled i.e name, amount in words and rupees, date, signature are to be filled without fail. Default of any of the required information or mismatching of any required information leads to dishonour of cheque.

- **Applicability of fund:** The balance of amount in customer account should be applicable to the presented cheque. If the availability of fund is not applicable to the payment of cheque then the banker need not honour the cheque. For example if there is any trust fund, it has to be utilized for the purpose of beneficiary and it should not be applicable to payment of any other cheque. Therefore while considering the cheque banker should focus on applicability of fund.

- **Time and hours presentation of bank and of working cheque:** The banker must accept the cheque presented in working hours of bank and if it is presented after working hours the acceptance and rejection is left to the banker. Presented cheque should belong to the branch where the customer has account and presentation of right cheque in right branch should be acceptable otherwise it may not be acceptable.

- **Legal Restriction:** The banker must honour the cheque if there is no legal restriction on customer cheque, if there is any legal restriction banker should not honour the cheque.

- **Outstanding Cheques for Collection:** When customer cheque is presented for payment, if there is sufficient amount in account then the banker should accept the cheque if there is no sufficient balance but if there is any outstanding cheques which is deposited for collection in such circumstances the banker no need to accept the cheque. The cheque deposited for collection but not yet collected is not to be considered while honouring the cheque.

b. Obligation to Maintain Secrecy of Customer's Account: It is banker obligation to maintain secrecy of customer accounts. Banker should not disclose customer account information to outsiders because it may affect the reputation of customer, credit worthiness of customer or it even badly damage the business of customer that is competitors surely will take advantages if they get any source of accounting information relating to company. So it is banker responsibility to maintain secrecy of customer account. Bank is liable to pay damages to the customer for loss of money and reputation due to failure to maintain customer account secrecy.

The banker can disclose information in the following grounds

- **Disclosure of Information under Compulsion of Law:** Banker has to obey the law and it has to disclose the customer's account information when law compelled to furnish and it is bank's obligation to disclose information to the extent of asked by the law and not more than that. There are many act under these banker has to furnish accounting information. They are namely
  - ✓ Section 4 of Banker's Book Evidence Act, 1891
  - ✓ Section 94 (3) of Code of Civil Procedure Act, 1908
  - ✓ Section 45 (B) of Reserve Bank of India Act, 1934
  - ✓ Section 26 of Banking Regulation Act, 1949
  - ✓ Section 36 of Gift Tax Act, 1958
  - ✓ Section 131, 133 of Income Tax Act, 1961

  When these authorities ask customer accounting information bank has to provide.

- **Disclosure of Information under Banking Practice:** The banker can disclose the account information of the customer in his own interest. Suppose if the customer fails to repay the debt amount, usually the bank ask the guarantor and the bank disclose the accounting information of the customer to guarantor with his own interest.

- **Disclosure by the Instruction of Customer:** Banker must disclose the customer accounting information with the prior permission and will of the customer. At the time of auditing, auditor can fully examine the accounting information of the customer and it is expressed consent and when the customer get any loan by naming guarantor it is implied consent that the banker can disclose the accounting information to the auditor and guarantor.
- **Disclose for the Interest of the Nation:** If the customer is dealing with any illegal activity it is dangerous for the nation and to safeguard the public and nation, it is banker duty to disclose the customer information to concerned authority.
- **Disclosure as Common Courtesy:** Banker can share a piece of accounting information of customer with the fellow banker as common courtesy. Fellow banker asks details of customer under few circumstances like issuing letter of credit, discounting bills etc. by these circumstances banker will disclose the information.

2. Rights

a. Banker's Lien: A lien is **the right of creditor to possess the goods and securities that belongs to borrower with him until the debt is repaid.** In other words it is right to retain possession of specific goods or securities of which the ownership vest in some other person and possession can be retained till the borrower discharge the debt amount to creditor.

- **Particular Lien:** Particular Lien is one under which **the creditor can retain the goods of debtor relating to the particular loan or particular amount due only**. Under particular lien the lender can enjoy the possession of goods on particular debt only and after the clearance of particular debt the goods will be repossessed by the real owner of the asset.
- **General Lien:** General Lien states **creditor's right to retain all the goods and assets against general amount due i.e. all amount due by the debtor**. Under general lien creditor can retain all the goods of debtor against total amount.

Following requirements are necessary for bank to enjoy lien

- The assets should be under the possession of bank.
- The asset which is there with the banker as security should belong to the customer (debtor) only.
- When the bank holds possession of property the banker must act in capacity as banker only.
- The deposit of property should not be for specific purpose and there must be expressed or implied agreement between banker and customer to exercise lien right.
- The possession of goods must be lawful.
- There should be amount due by the customer to the banker to get the right of lien.

The banker cannot enjoy the right of lien on following circumstances

- **Safe custody deposit:** Banker cannot hold the right of lien on safe custody deposits. Under these circumstances, banker acts as bailee to customer and not as the capacity of banker. So as per law banker cannot exercise the lien on safe custody deposits.
- **Bills or instruments deposited for collection or any other specific purpose:** When customer deposit any bills or instruments for collection purpose or any other specific purpose like purchase

of securities then bank cannot exercise the right of lien because here it is implied agreement between banker and customer that the fund must be utilized for specific purpose and banker acts as agent of customer and not in the capacity of banker.

- **Trust amount or property:** Banker should not possess the right of lien on trust amount. There is certain instructions for the banker on the usage of funds in some specific manner and as per expressed consent banker must utilize the same for mentioned purpose and moreover here bank never acts in the capacity of banker but acts as trustee.

- **Illegal possession of goods:** Illegal possession of goods do not entrust banker's right of lien. If customer left the securities by mistake or properties come to the banker without awareness of customer then banker cannot exercise the lien because the banker must have legal possession of article.

- **Prior due date of loan:** Bank can exercise lien after the completion of loan's due date i.e., when bank lends loan it fixes the time period to return the loan. Actual liability occurs on or after the due date. Hence banker can possess the right of lien on customer goods only after the due date of loan and prior to the due date of loan.

- **Bonds and coupons:** Lien is not applicable for bonds and coupons which are received for collection. Here the banker acts as an agent of customer but not in the capacity of banker. As per law, if banker acts as an agent lien is not applicable.

- **Stolen goods:** If customer pledges any assets which is stolen and has been be granted loan by the bank, in such circumstances as the customer is not the real owner of the asset; the banker cannot exercise the right of lien on those stolen goods.

- **No simultaneous right to bank:** When right of set off is available to bank then bank cannot possess the right of lien. Generally at a time bank cannot possess both the right.

b. Banker's right to charge interest: It is implied right of banker to **charge interest on outstanding balance due by the customer**. When customer is awarded loan from banker, it charges interest on loan amount and if customer not paid the previous loan installment at this moment banker has right to charge compound interest i.e. interest on interest.

When customer avails **bank overdraft facility, banker charges the interest to the extent of overdrawn amount**. Normally bank charges interest on overdraft on every last day of every month and in other circumstances generally it charges interest on quarterly or once in half year.

c. Banker's right to charge commission: Nowadays banks provide many banking services to customer because of increased competition and to retain and gain more customers. At the same time **when bank provides any services it possess right to charge commission on the service**. The various service provided by the banks are safe custody facility, purchase and sale of shares, debentures, factoring etc and it charges commission on these services.

d. Right to Charge Incidental Charges: Incidental charges refer to the charges levied by the banker on non-remunerative account. In other words it is charges on non-profit generating account. Generally bank charges incidental charges on current account because as **like saving account, current account does not generate more profit to bank because banker cannot utilizes the current account fund for their investment because it is subjected to liquidity and transactions are many in current account. So in order to earn profit from current account it charges incidental charges**, if current account is not subjected to fluctuate and the balance in the account is stable then banker may not charge incidental charges or may charge less incidental charges.

e. Right to charge commitment charges: Commitment charges refer to **the charges deducted by the banker from the customer account on the unutilized amount from the bank overdraft or cash credit**. When banker provides bank overdraft and cash credit to customer, it transfers entire sanctioned amount to customer account and charges interest on utilized amount but if customer does not utilize maximum amount, banker may not get more profits so it charges commitment charges.

f. Banker's right to set off: It is a statutory right of banker to **combine two or accounts of customer who has debit and credit balance and it is being done to know the net balance due from customer or by banker**.

Example: Mr. R has an saving bank account with the XYZ bank and the balance is Rs 15,000 and in same bank he has a loan account of Rs 10,000 here the bank can combine both account to know the net balance due to customer or from the customer. Here customer Debit balance is Rs 15,000 and Credit balance is Rs 10,000 and net due to customer is Rs 5,000.

The following conditions are essential to exercise right of set off

- The debt must be a sum certain and due immediately.
- The debt must be due by and to the same parties.
- The both the parties i.e. bank and customer should be in the same capacity of debtor and creditor.
- There should be no specific agreement relating account and fund.
- The account from which the firm transfers funds must be held by the customer who owes the firm money.

Under the following situation banker can automatically set off customer's account

- When customer dies.
- When customer becomes mental incapable.
- When customer declared as insolvent.
- On the receipt of garnishee order.
- At the time of winding up of company.
- Fraud by the customer by pledging asset with another bank which is already kept with one bank.

The right of set off cannot be applicable for the following circumstances

- The right of set off is not applicable for trust account i.e. fund deposited for specific purpose.
- It is not applicable for partnership account and the account of one partner i.e., it is not possible to combine debit or credit balance of partnership account and the debit or credit balance of one partner account.

- It is not applicable for dividend account of company and loan of the same company.
- Joint account and single account cannot be combined and the right of set off is not applicable.
- Account of guardian and minor account cannot be combined and set off is not applicable because of different parties.
- It is not applicable for the same party's account but acting in different capacity.

Difference between Lien and Set Off

Lien	Set Off
Banker Lien is recognized under section 171 of the Contract Act.	Set off is a right under customary law of banker.
Lien is related to goods and security of customer.	Set off is related to money claims.
Lien is the right to retain customer goods and security.	Set off is the right of banker to combine more than one account of customer to ascertain final balance due to him or due by him.
Notice is not required to exercise lien.	Notice is required in some of the cases of the set off.
Lien precedes set off.	Set off follows lien

g. Right of apportion of payment: When customer has more than one loan commitment and lack of sufficient balance to clear all the debt at that time the question of apportion arises. If the customer account balance is not sufficient to clear all the debt then the customer can specify which debt has to be cleared and which one should not to be cleared i.e. the decision is left to customer regarding proper apportion of scared amount to clearing of various debt. Bank here acts according to expressed instruction of customer.

If there is no instruction of apportion of money from the customer then banker has right to appropriate payment. It can appropriate the payment as it wants there is no restriction on appropriation of payment but the payment has to be appropriate towards legal debt and should not appropriate to illegal debt and even it can appropriate payment to time barred debt also but it has to inform to customer regarding appropriation of payment.

h. Right to produce the books of accounts: Earlier days when the customer is sued by the other banker has to produce customer's original books of accounts as evidence before the court even though he was not a party to the suit.

As per Banker's Book Evidence Act 1891 if banker is not a party to the suit, there is no need for the banker to produce the original books of customers just attested copy of the banker is enough for the court as evidence and need to produce the entire books, just required information has to be produced.

If court is not satisfied with the banker's information then court may ask the banker to give original books of account of customer. If banker is party to the suit then banker must produce the original books of customer.

i. Right under Garnishee order: Garnishee order is an order issued by court to third party (Garnishee) for not to make any payment to judgment debtor till further court direction and this order will be issued by the request of judgment creditor By the receipt of garnishee order the garnishee (bank) must suspend the account of customer and same has to be informed to customer. Court decides the amount and attaches to the judgment creditor from garnishee account, bank must discharge the attached amount to judgment creditor if any amount left after payment remaining amount can be given to customer of bank.

The garnishee order can be issued in two step 1st Ans

- **First phase - Order nisi:** Order nisi is the first phase of court order given to garnishee. On receipt of order nisi garnishee (bank) must suspend the account of customer and stop the payments to customer and he should inform the same to customer in order to avoid dishonor of cheques. Here court seeks explanation from the bank as to why the amount in the account should not be utilized for making payment to judgment creditor and bank should wait until further order from the court.

- **Second phase – Order absolute:** After Garnishee files explanations; bank may pass final order that is called order absolute. Entire balance in the account or specified part of the balance is handed over to judgment creditor as per the order by the court. Bank must discharge the amount to the judgment creditor and later the customer account can be reviewed.

Garnishee order does not apply to the following

- **Uncleared Negotiable instruments:** The amounts of cheques, drafts, bills etc., sent for collection by the customer, which remain uncleared at the time of the receipts of the order.

- **Amount deposited succeeding the Garnishee order:** Garnishee order cannot attach the amounts deposited into the customer's account after the Garnishee order has been served on the banker. Garnishee order applies to the current balance at the time the order is served.

- **Payments made in advance to Garnishee order:** Garnishee order is not effective in the payments already made by the banker before the order is served upon him. But if the cheque is presented to the banker for payment and its actual payment has not yet been made by the banker and in the meanwhile the Garnishee order is served upon him, the later must stop payment of the said cheques, even it is passed for payment.

- **Expiration of cheques:** The effectiveness of the Garnishee order depends upon the fact whether the time for returning the dishonoured cheques to the collecting banker have expired or not. Every drawee bank is given specified time within which it has to return the unpaid cheques, to the collecting bank. If such time has not expired and in the meanwhile the bank receives a Garnishee order, it may return the cheque as dishonoured. But if the order is received after such time over, the payment is deemed to have been made by the paying banker and the order shall not be applicable to such amount.

- **Joint account:** Garnishee order is not applicable for joint account if any person is judgment debtor. Incase if all the parties are judgment debtor then joint account also applicable to Garnishee order otherwise not.

- **Partnership account:** Garnishee order cannot be attached to partnership account where any one of the partner is judgment debtor. Incase if both or all the partners are judgment debtor at then the Garnishee order applies for that account.

- **Trust account:** In trust account banker and the customer will possess trustee and principal relationship but not creditor and debtor relationship. So Garnishee order does not apply for trust account.

- **Others:**
  - ✓ Money held abroad by the judgment debtors
  - ✓ Securities held in the safe custody of the banker

Bank's procedure on receipt of Garnishee order

- If the order is served on the bank's head office, then the branch where the account is held should be notified for which a reasonable time is always allowed.
- Attachment of amount is not applicable, if the customer is not debtor to the bank, in such circumstance Garnishee order will be withdrawn.
- When the banker receives Garnishee order he should confirm the correct customer name and after concludes him as judgment debtor.
- Customer should be advised of the order and also the banker's intention to comply with the order.
- When the customer has large amounts with the banker and attached amount is less than the balance in such situation banker can open a separate account and transfer the remaining balance after attaching amount to judgment creditor. If the court attaches the full amount of customer then banker should not transfer any amount to customer's new account.

Bank lending: It is the process whereby banks issue loans to borrowers. The nature of their activities, the location of business, financial stability, earning, repaying capacity, purpose of advance, securities etc differ and their degree of their risk also differ. Therefore bank must take proper precaution in this process.

Principles of Bank lending

1. **Safety:** Safety means borrower should be able to repay the loan and interest in time at regular intervals without default. The safety of bank funds depends upon the technical feasibility and economic viability of the project for which the loan is advanced. Above all the repayment of the loan depends upon the nature of security, the character of the borrower, his capacity to repay and his financial standing.

2. **Liquidity:** Liquidity refers to convertibility into Cash. Liquidity is an important principle of bank lending. The major portion of bank deposits is repayable on demand or at a short notice. Therefore the bank must see it that advances are not locked up but come back immediately. It is essential because if the bank needs cash to meet the urgent requirements of its customers, it should be in a position to sell some of the securities at a very short notice without disturbing their market prices much. There are certain securities such as central, state and local government bonds which are easily saleable without affecting their market prices.

3. **Diversification:** In choosing its investment portfolio, a commercial bank should follow the principle of diversity. A bank should not invest all its funds in one industry. In case that industry fails, the banker will not be able to recover his loans. Hence, the bank may also fail. It should not invest its surplus funds in a particular type of security but in different types of securities. It should choose the shares and debentures of different types of industries situated in different regions of the country. Diversification aims at minimising risk of the investment portfolio of a bank.

4. **Profitability:** To earn profits banks should invest in such securities which surely gives a fair and stable return on the funds invested. The earning capacity of shares and securities depends upon the interest rate, dividend rate and tax benefits they carry. Banks should largely invest in government securities rather than the shares of new companies because shares of new companies are not safe investments.

5. **Purpose/Object of loan:** Loans should be extended for the productive purpose only, either for meeting so that the money not only remain safe but also provides a definite source of repayment. If a loan is required for a non-productive or speculative purpose, the banker should be very cautious in entertaining such proposals. It is very difficult to ensure that the loan has been utilized for the purpose for which it was sanctioned. Banker should take follow up measures to ensure end use of fund exactly for the same purpose for which it is borrowed.

6. **Security:** Bank loan should be granted only after obtaining a proper security. So that in case of failure on the part of a borrower to repay the loan, the banker may, dispose off the available security and recover the bank funds.

7. **Stability:** Another important principle of a bank's investment policy should be to invest in those stocks and securities which possess a high degree of stability in their prices. The bank cannot afford any loss on the value of its securities. It should, therefore, invest it funds in the shares of reputed companies where the possibility of decline in their prices is remote.

8. **National interest:** Bank has a significant role in the economic development of the country. Along with safety, liquidity and profitability they should keep in mind the national development while going for lending. Reserve Bank also gives directives to banks to invest a certain percentage of loans and advances in priority sectors, viz, agriculture, small scale, and tiny sector, and export-oriented industries, etc.

9. **Character of the borrower:** The bank should carefully examine the character of the borrower. Character implies honesty, integrity, creditworthiness, and capacity of the borrower to return the loan. In case a person fails to verify the character of the borrower, the loans and advances might become bad debts for the bank.

10. **Margin money:** In the case of secured loans, the bank should carefully examine and value the security. There should be a sufficient margin between the amount of loan and the value of the security. If an adequate margin is not maintained, the loan might become unsecured in case the borrower fails to pay the interest and return the loan. The amount of loan should not exceed 60 to

70% of the value of the security. In case if it exceeds, the loan might become unsecured and the bank has to suffer a loss on account of bad debt.

11. **<u>Principle of Solvency</u>:** Solvency means financial sufficiency or capability in the capital. Banks maintain sufficient capital to help run their business smoothly. The main source of funds of the commercial bank is the deposited money by the customers through a variety of accounts.

12. **<u>Principle of Services</u>:** The success of commercial banks depends on the services they provide to their customers because customers choose those banks that offer improved services. So, banks ensure they provide the best services to their customers.

13. **<u>Principle of Secrecy</u>:** Customers prefer to keep secrets about their money and valuable assets. So banks are required to keep secrets about the accounts of their customer.

(NOTE: First 8 points of bank lending are very important)

<u>RBI:</u> Reserve Bank of India was established in 1935 with a share capital of Rs 5 crores in accordance with the provisions of RBI Act 1934 on the basis of the recommendations of the Hilton Young Commission. It was nationalized on 1st January 1949. It is entrusted with the responsibility of guiding and regulating the banking system. Banking regulation Act 1949 empowered the RBI to regulate, control and inspect the banks in India and also provided that no new bank or branch of an existing bank could be opened without a license from the RBI.

<u>Role or Functions</u>

1. **<u>Issue of Notes:</u>** The RBI has the sole right to issue currency notes except one rupee notes which are issued by the Ministry of Finance. This concentration of notes issue function, RBI has a number of advantages
   - It brings uniformity in notes issue
   - It makes possible effective state supervision
   - It is easier to control and regulate credit in accordance with the requirements in the economy
   - It keeps faith of the public in the paper currency

2. **<u>Banker to the Government:</u>** The Reserve Bank act as the Banker, Agent and Adviser to the Government of India and states. It performs all the banking functions of the State and Central Government that is it undertakes to accept money on account of government, to make payments on its behalf and also to carry out its exchange remittance and other banking operations. It also tenders useful advice to the government on matters related to economic and monetary policy.

3. **<u>Banker's Bank:</u>** The Reserve Bank performs the same functions for the other commercial banks as the other banks ordinarily perform for their customers. RBI lends money to all the commercial banks of the country.

4. **<u>Licensing:</u>** The licensing procedure of the financial institutions is under RBI. It is RBI who approves the license the institutions such as commercial banks, cooperative banks, non banking finance company etc.

5. **Controller of the Credit:** RBI regulates and supervises the supply of money and credits as per Government guidelines RBI uses quantitative and qualitative techniques to control and regulate the credit flow in the country. When RBI observes that the economy has sufficient money supply and it may cause an inflationary situation in the country then it squeezes the money supply through its tight monetary policy and vice versa. It also decides how much money is to be circulated in the market to maintain the financial stability.

6. **Custodian of Foreign Reserves:** For the purpose of keeping the foreign exchange rates stable, the RBI buys and sells foreign currencies. RBI sells the foreign currency in the foreign exchange market when its supply decreases in the economy and vice-versa. It helps the RBI to deal with crisis connected with adverse balance of payments position.

7. **Custodian of cash reserves of commercial banks:** The commercial banks are required to maintain the cash reserves at a rate decided by the RBI in its monetary policy.

8. **Regulators and settlement of Payment system:** RBI introduces and upgrades safe and efficient modes of payment systems in the country to meet the requirements of the public. It includes implementing various advanced technologies like NEFT, RTGS, IMPS, UPI (Unified Payment System) etc.

9. **Lender of last resort:** RBI acts as parent for all the banks in India. The RBI is the ultimate solution for every problem of banks in India. In case of any crisis RBI helps them by lending money.

10. **Appointment of CEO/Chairman of any Bank:** RBI appoints the CEO/ Chairman/ CMD of whether it nationalized banks or private sector banks. In fact, the top authority of any scheduled banks can be appointed only from the final approval of RBI.

11. **Research and Development:** RBI is also responsible for surveying, research, customer satisfaction, public awareness, circulation of essential information and cautions regarding frauds in banking. It regularly performs the process of research and development to provide better banking services to consumers.

Monetary Policy: Monetary policy is a regulatory policy or process through which the monetary authority of a country or the central bank controls the supply of money in the economy by its control over the interest rates in order to maintain the price stability and achieve the high economic growth. The various weapons of credit control are

I. Quantitative Credit Control Methods: Quantitative credit controls are used to maintain proper quantity of credit and money supply in market. Some of the Quantitative credit control methods are

1. **Bank Rate Policy:** Bank rate is the rate at which the Central bank (RBI) lends money to the commercial banks for their liquidity (Cash) requirements. Bank rate is also called discount rate. Increase in bank rate discourages the banks from borrowing and thus lend out less money. Reduction in bank rate encourages the banks to borrow more which makes more money available for lending.

2. **Open Market Operations:** It refers to buying and selling of government securities in open market in order to expand or contract the amount of money in the banking system. This technique is superior to bank rate policy. Purchases inject money into the banking system while sale of securities (instruments) do the opposite.

3. **Cash Reserve Ratio (CRR):** The Cash Reserve Ratio (CRR) is an effective instrument of credit control. Under the RBI Act, 1934 every commercial bank has to keep certain minimum cash reserves with RBI. A high CRR reduces the cash with commercial banks for lending and a low CRR increases the cash with commercial banks for lending.

4. **Statutory Liquidity Ratio (SLR):** Statutory Liquidity Ratio refers to the amount that the commercial banks require to maintain a certain ratio of its total deposits with RBI in the form of liquid assets like cash, or gold or government approved securities before providing credit to the customers.

5. **Repo rates:** Repo rate is the rate at which RBI lends money to commercial banks against securities. Repo rate helps commercial banks to acquire funds from RBI against the securities and also agreeing to repurchase at a later date.

6. **Reverse repo rate:** Reverse repo rate is the rate at which commercial banks lends money to RBI against securities.

II. Selective / Qualitative Credit Control Methods: Under Selective Credit Control, credit is provided to selected borrowers for selected purpose that is extension of credit to essential purposes is encouraged and to non-essential purposes is discouraged. Hence these methods not only prevent the flow of credit into undesirable channels but also direct the flow of credit to useful channels. The Selective Controls are

1. **Ceiling on Credit:** The Ceiling on level of credit restricts the lending capacity of a bank to grant advances. To ensure overall development of a nation, development of various sectors is a must. Finance is to be distributed to various sectors as per these requirements. Priority sector should be given preference in lending loans and for others, minimum attention only will be given in this respect. It paves way for the optimum utilization of money.

2. **Margin Requirements:** The term margin denotes **that part of the loan amount, which cannot be borrowed from bank**. RBI has power to vary the margin requirements depending upon the business conditions prevailing in the country. By using this method, during the period of inflation with a view to control credit, the RBI **raises the margin and during deflation it lowers the margin to expand the credit**. This method also enables the commercial banks to direct their funds to essential activities rather than speculative activities.

3. **Discriminatory Interest Rate (DIR):** Through DIR, RBI makes **credit flow to certain priority or weaker sectors by charging concessional rates of interest**. RBI issues supplementary instructions regarding granting of additional credit against sensitive commodities, issue of guarantees, making advances etc.

4. **Directives:** The RBI issues directives to banks regarding advances. Directives are regarding the purpose for which loans may or may not be given.

5. **Moral Suasion:** Under Moral Suasion, RBI issues **periodical letters to bank** to exercise control over credit or advances against particular commodities. **Periodic discussions** are held with authorities of commercial banks in this respect.

6. **Direct Action:** It is too severe and is therefore rarely followed. It may involve refusal by RBI to **rediscount bills or cancellation of license**, if the bank has failed to comply with the directives of RBI.

Assignment Questions

Section A 3 & 5

1. Give the meaning of order nisi and order absolute? Pg 20
2. Who is banker and customer? 11
3. Give the meaning of Garnishee order, lien and set off? 20 16 18
4. What is mobile banking? 11
5. Expand: NABARD, SIDBI, RBI, EXIM, NHB Pg 5
6. Define Bank. Pg 1
7. What is particular and general lien? 16

Section B

1. Give the difference between commercial and non-commercial banks. Pg 6 & 7
2. Explain the role of commercial banks? 8, 9, 10, 11
3. Distinguish between lien and set off. Pg 19

Section C

1. Explain in brief the structure of banking sector in India. 3 - 6
2. Explain the functions of commercial banks. (Any of the function can be asked individually) 8 - 11
3. Explain the relationship between the banker and the customer. (Any of the relationship can be asked individually) ~~8, 9,~~ 10, 12 - 21
4. What is bank lending? Explain the principles of bank lending. 21 - 23
5. Explain the role of RBI in Indian Economy. 23 - 24
6. Explain the right under Garnishee order. 20 - 21