

B.COM
Year – II
Semester – IV
Paper - V

Banking Theory Law and Practice



Centre for Distance and Online Education

श्रीचन्द्रशेखरेन्द्रसरस्वतीविश्वमहाविद्यालयः

Sri Chandrasekharendra Saraswathi Viswa Mahavidyalaya

Deemed to be University u/s 3 of UGC Act 1956 - Accredited with 'A' grade by NAAC

Enathur, Kanchipuram 631561.

Sponsored and run by Sri Kanchi Kamakoti Peetam Charitable Trust

Course Writers

Dr. C. Kathirvel Babu
Assistant Professor
CDOE
SCSVMV

Dr. P. Balaji
Assistant Professor
Department of Commerce
SCSVMV

Programme Coordinator

Mr. S. Swaraj
Assistant Professor,
CDOE
SCSVMV

Chief Editors

Dr. B. Balaji Srinivasan
Director, CDOE
SCSVMV

Dr. Hema Narayanan
Head of the Department,
Department of Commerce,
SCSVMV

BC415 – Banking Theory Law and Practices

Course Objectives

1. To understand the framework of banking regulation and the role of the Reserve Bank of India in credit control.
2. To study the types, functions, and operations of banks, including modern electronic banking services.
3. To learn procedures for account opening, types of customers, and customer relationship management.
4. To analyze principles of lending, loan evaluation, types of credit, and risk management in banking.
5. To understand negotiable instruments, their features, legal provisions, and roles of paying and collecting bankers.

UNIT I

Banking Regulation Act, 1949 – Salient features-[Definition of Banking, Licensing, Opening of branches, Functions of Banks, Inspection] – Reserve Bank of India- functions-credit control mechanism.

UNIT II

Types of banks - Unit Banking – Branch Banking – Indian Commercial Banks, Nationalization of Major Commercial Banks – Functions of commercial banks – Accepting Deposits – Lending of Funds - E-Banking – ATM Cards, Debit cards, Personal Identification Number – Online enquiry and update facility – Electronic Fund Transfer – Electronic Clearing System – credit creation.

UNIT III

Opening of an Account- Types of Deposit Account – Types of customers (Individuals, firms, Trusts, and Companies) – Importance of customer relations – Customer grievances and its redressal measures– Ombudsman.

UNIT IV

Principles of lending – Safety of funds- Liquidity- Profitability- Purpose of loan- Security- Repayment capacity- Diversification of risk- Social responsibility-Types of Borrowings –

Short-term loans - Medium-term loans- Long-term loans- Cash Credit- Overdraft - Bills Discounting / Bills Purchase - Advances against securities- Precautions to be taken by a banker - Verification of purpose of loan- Adequate and marketable security - Compliance with legal and regulatory requirements - Evaluation of repayment capacity - Proper documentation

UNIT V

Negotiable instruments: Promissory Note – Bills of Exchange, Cheque, Draft – Definitions, Features – Crossing – Endorsement – Material Alteration – Paying Banker – Rights and Duties – Statutory Protection – Dishonour of Cheques – Role of collecting banker.

Course Outcomes

1. Students will be able to explain the provisions of the Banking Regulation Act, 1949, and the functions of RBI.
2. Students will be able to describe the types of banks, banking services, and credit creation mechanisms.
3. Students will be able to handle account opening procedures and understand customer relationship and grievance redressal mechanisms.
4. Students will be able to evaluate loan applications, apply principles of lending, and ensure compliance with banking norms.
5. Students will be able to account for and manage negotiable instruments and understand the legal duties and protections of bankers.

Text Book

1. Banking Theory, Law & Practice – B. Santhanam, Margham Publications
2. Banking Theory, Law & Practice- K. P. M. Sundaram & P. N. Varshney-Sultan Chand & Son- 2015
3. Banking and Financial Dr. K. Nirmala Prasad, J. Chandra doss, System in India – Himalaya Publishing House
4. K P M. Sundaram & Varshney - Banking Theory, Sultan Chand
5. M. Radhasamy & S. Vasudevan - Text of Banking Gomez - Banking & Finance Desai Vasanth - Indian Banking, Nature & Problem

Textbooks

1. Banking Theory, Law & Practice – K.C. Shekhar & Lekshmy Shekhar
2. Banking Law & Practice – S. Gurusamy
3. Principles of Banking – Indian Institute of Banking & Finance (IIBF)
4. Modern Banking – R.S. Sayers & K.P.M. Sundaram
5. Fundamentals of Banking – M.Y. Khan

Reference Books

1. Banking and Financial Systems – Dr. K.N. Bhatia
2. Principles and Practices of Banking – Indian Institute of Banking & Finance (IIBF)
3. Commercial Banking – R.G. Sharma
4. Banking Law & Operations – L.C. Gupta
5. Contemporary Banking Theory and Practice – Peter S. Rose & Sylvia Hudgins

BC415 – Banking Theory Law and Practices

CONTENTS

S.No	UNIT No.	Page No.
1	UNIT-I	1
2	UNIT-II	69
3	UNIT-III	80
4	UNIT-IV	87
5	UNIT-V	101

BC415 – Banking Theory, Law & Practice

UNIT I

1.1 Overview of Banking in India

1.2 Need for Banking Regulation

1.3 Evolution of Banking Regulation Act, 1949

1.4. Meaning and Purpose

1.5. Objectives of the Banking Regulation Act, 1949

1.6. Scope and Applicability

1.7. Features of the Banking Regulation Act, 1949

1.8. Introduction

1.9. Legal Definition

1.10. Elements of the Definition (Detailed Breakdown)

1.11 Essential Characteristics of a Bank (Based on Definition)

1.12 Difference between Banks and NBFCs (Based on Definition)

1.13 Why the Definition Was Needed

1.14 Meaning of “Banking Company” (Section 5(c))

1.15 Significance of the Definition in Regulation

1.16. Illustrations and Examples

1.17. Diagrammatic Representation of Definition

1.18. Licensing of Banks (Section 22)

1.19. Why Is Licensing Necessary?

- 1.20. Conditions for Granting a Banking License**
- 1.21. Types of Banking Licenses in India**
- 1.22. Procedure for Obtaining a Banking License**
- 1.23. Grounds for Refusal or Cancellation of License**
- 1.24. Licensing of Foreign Banks (Section 22A)**
- 1.25. Opening of Branches (Section 23)**
- 1.26. Why Is RBI Involved in Branch Expansion?**
- 1.27. What is a “Branch”? (Meaning under the Act)**
- 1.28. Conditions for Opening a Branch**
- 1.29. The Branch Authorization Policy**
- 1.30. Procedure for Opening a Branch**
- 1.31. Shifting or Closing Branches**
- 1.32. Foreign Banks – Branch Rules**
- 1.33. Benefits of Regulated Branch Expansion**
- 1.34. Accepting Deposits**
- 1.35. Types of Deposits**
- 1.36. Types of Loans and Advances**
- 1.37. Agency Functions**
- 1.38. General Utility Functions**
- 1.39. Digital and Electronic Banking**
- 1.40. Comparison: Traditional vs. Modern Banking**
- 1.41. Inspection of Banks – Introduction**

- 1.42. Objectives of Bank Inspection**
- 1.43. Legal Basis for Inspection (Section 35)**
- 1.44. Types of Bank Inspection Conducted by RBI**
- 1.45. Procedure for Conducting Inspection**
- 1.46. Focus Areas of Inspection**
- 1.47. Rights and Duties of the RBI during Inspection**
- 1.48. Consequences of Adverse Inspection Reports**
- 1.49. Importance of Bank Inspection**
- 1.50. Establishment of RBI – Historical Background**
- 1.51. Objectives of RBI**
- 1.52. Organisation & Structure of RBI**
- 1.53. Governor and Deputy Governors**
- 1.54. Departments of RBI**
- 1.55. RBI Offices and Branch Network**
- 1.56. Issue of Currency (Sole Right)**
- 1.57. Banker to Government**
- 1.58. Banker's Bank**
- 1.59. Controller of Credit (Monetary Authority)**
- 1.60. Custodian of Foreign Exchange**
- 1.61. Banker to Banks (Clearing House)**
- 1.62. Controller of Banking System (Regulator)**
- 1.63. Conclusion / overview**

1.1 Overview of Banking in India

The banking system in India is one of the most regulated, organized, and systematically structured sectors. Banks serve as the backbone of the economy by mobilizing savings, facilitating commerce, providing credit, enabling financial inclusion, and supporting economic development. Because banks handle public money, their operations must be monitored, controlled, and governed under strong regulatory rules.

The central authority responsible for this regulatory framework is the Reserve Bank of India (RBI), supported by the Banking Regulation Act, 1949. These two pillars ensure that Indian banking functions smoothly, transparently, and efficiently.

Before independence, Indian banking was weakly regulated, leading to frequent bank failures. After several collapses, the Government of India realized the urgent need for an effective law that could govern:

- How banks begin operations
- How they manage deposits
- How they lend safely
- How they maintain reserves
- How they protect people's money
- How they follow financial discipline

This led to the enactment of the Banking Companies Act, 1949, later renamed as the Banking Regulation Act, 1949.

1.2 Need for Banking Regulation

Banking is a unique business. Unlike general companies, banks operate with *public deposits*—money belonging to millions of individuals. Therefore, even a small mismanagement can lead to huge losses, bankruptcies, or collapse of public confidence.

1.3 Evolution of Banking Regulation Act, 1949

1.3.1 Banking Before Regulation

Before 1949:

- Many banks were privately owned.
- There were no proper licensing rules.
- No uniform rules for lending.
- Many banks collapsed due to mismanagement.
- Customers had no protection.

1.3.2 Enactment of the Act

- Passed as **Banking Companies Act, 1949**
- Came into force from **16 March 1949**
- Later amended and renamed as **Banking Regulation Act, 1949 (1965)**
- Applied to:
 - Commercial banks
 - Foreign banks operating in India
 - Some cooperative banks (with amendments)

1.3.3 Key Amendments Over Time

- Introduction of **licensing** (Sec 22)
- Strengthening of **branch control** (Sec 23)
- Powers of **RBI inspection** expanded (Sec 35)
- Rules for **management, mergers, winding up**
- Corporate governance norms
- Inclusion of cooperative banks under regulation

1.4 Structure of Unit I

This unit is divided into the following major components:

1. Banking Regulation Act, 1949

- Definition of Banking
- Licensing of Banks
- Opening of Branches
- Functions of Banks
- Inspection of Banks

2. Reserve Bank of India

- Establishment and history
- Organizational structure
- Functions
- Role as central bank

3. Credit Control Mechanism

- Quantitative tools
- Qualitative tools
- Objectives and significance

By the end of this unit, you should be able to understand how the Indian banking system is regulated, why regulation is essential, and how the RBI controls credit in the economy.

BANKING REGULATION ACT, 1949

1.4. Meaning and Purpose

The Banking Regulation Act, 1949 is a comprehensive legislation that regulates:

- Banking business
- Management of banks
- Licensing

- Branch expansion
- Maintenance of capital and reserves
- Control over operations
- Inspection and supervision

Its primary objective is to ensure that banks operate in the interest of the public and the economy.

1.5. Objectives of the Banking Regulation Act, 1949

1. Regulate Banking Companies

To control formation, functioning, and management of banking companies.

2. Safeguard Depositors' Interests

Depositors are at the core of banking, and the Act ensures their protection.

3. Ensure Sound Banking

By enforcing liquidity norms, minimum capital requirements, and restrictions on loans and advances.

4. Provide RBI with Supervisory Powers

The Act gives RBI necessary authority to inspect books, control policy, and regulate operations.

5. Prevent Bank Mismanagement

It restricts loans to directors, prohibits heavy speculative advances, and promotes good governance.

6. Promote Development and Stability

By controlling credit, regulating mergers, and encouraging financial inclusion.

1.6. Scope and Applicability

The Act applies to:

- All **banking companies** in India
- All **foreign banks** operating in India
- Certain **cooperative banks** (with amendments)
- Financial institutions involved in accepting deposits and lending

It does **not** apply to:

- NBFCs
- Chit funds
- Nidhi companies
- Post office savings banks

1.7. Features of the Banking Regulation Act, 1949

The Act contains numerous provisions, but the following are its **salient features**:

1. Definition of Banking (Section 5(b))

Provides the legal meaning and scope of “banking”.

2. Licensing of Banks (Section 22)

No company can operate as a bank without RBI’s license.

3. Branch Expansion (Section 23)

Banks need RBI permission to open or close branches.

4. Minimum Capital Requirements

Ensures financial soundness.

5. Control Over Management

RBI controls the appointment of directors and CEOs.

6. Restrictions on Loans and Advances

Prevents reckless lending activity.

7. Inspection of Banks (Section 35)

RBI can inspect banks anytime.

8. Winding Up of Banks

Provision for amalgamation, mergers, or liquidation.

PART 1 SUMMARY

In this first section, we explored:

- The need for banking regulation
- Origin and evolution of the Banking Regulation Act
- Purpose and significance of the Act
- Salient features and scope

MEANING AND SCOPE OF BANKING

1.8. Introduction

Banking is one of the oldest economic activities in the world. The original purpose of banking was simple—to provide a safe place for people to keep their money. Over centuries, banks evolved into complex institutions involved in lending, investment, fund transfers, and financial advisory services.

Because banking involves public deposits and affects the entire economy, the Banking Regulation Act, 1949 provides a clear legal definition of “banking”. This definition forms the foundation upon which all banking activities, regulations, and operations are built.

1.9. Legal Definition

According to Section 5(b) of the Banking Regulation Act, 1949:

“Banking means accepting, for the purpose of lending or investment, deposits of money from the public, repayable on demand or otherwise, and withdrawable by cheque, draft, order or otherwise.”

Though this appears simple, the definition contains deep legal and economic meaning. Let us break it down part by part.

1.10. Elements of the Definition (Detailed Breakdown)

The definition contains five core components, each of which is essential for any institution to be legally recognized as a *bank*.

A. Accepting Deposits of Money

This is the primary function of any bank.

What are deposits?

Deposits are amounts of money placed by the public into the bank for:

- Safekeeping
- Earning interest
- Carrying out transactions
- Future needs

Importance of deposits

- They form the **main source of funds** for banks.
- Deposits are **public trust**, so they need regulatory protection.

B. Accepting Deposits “from the Public”

This phrase is important because banks serve the **general population**.

Implication:

Banks must accept deposits from:

- Individuals
- Firms
- Companies
- Societies
- Trusts
- Government institutions

Banks cannot restrict deposits only to a closed group like:

- Members
- Employees
- Family

Institutions that do so (like Nidhi companies) are **not banks**.

C. Purpose of Lending or Investment

Banks must deploy deposited funds in **productive uses**.

Banks use deposits for:

1. Lending:

- Personal loans
- Housing loans
- Business loans
- Agricultural loans
- Overdrafts and cash credit

2. Investments:

- Government securities
- Bonds
- Money market instruments

- Corporate debentures

Why is this important?

- A company that accepts deposits but does not lend/invest is *not* a bank.
- Example: Post Office Savings Bank accepts deposits but does not lend—so it is *not* a commercial bank.

D. Deposits must be “Repayable on Demand or Otherwise”

This phrase ensures depositor rights.

Repayable on Demand

- Withdrawal whenever customer wants
- Applicable for Savings and Current accounts

Repayable Otherwise

- After a fixed period
- Ex: Fixed deposit for 1 year, RD for 5 years

E. Withdrawable by Cheque, Draft, Order, or Otherwise

This is the **most distinguishing feature** of banking.

What does this imply?

Banks allow customers to withdraw money using:

1. **Cheques** – written orders to pay
2. **Drafts** – bank-issued payment instruments
3. **Orders** – instructions for payment
4. **Otherwise** – ATM, online banking, UPI, debit cards, etc.

Why is this important?

- Institutions that cannot issue cheques *cannot* be called banks.
- This differentiates banks from:
 - NBFCs
 - Mutual funds
 - Finance companies
 - Chit funds

Thus, the ability to allow withdrawal **through cheques** is a *defining legal feature*.

1.11 Essential Characteristics of a Bank (Based on Definition)

From the definition, we can identify the following characteristics:

1. Banks must accept deposits

Without accepting deposits, an institution cannot be a bank.

2. Deposits must come from the public

Not limited to a private group.

3. Deposits must be used for lending or investment

Not for speculation or illegal activities.

4. Deposits must be repayable

Ensures depositor security.

5. Withdrawal must be allowed through banking instruments

This gives banks a unique payment function.

1.12 Difference between Banks and NBFCs (Based on Definition)

Point	Banks	NBFCs
Accept Public Deposits	Yes	Limited / Restricted
Repayable on Demand	Yes	No
Withdrawable by Cheque	Yes	No
Regulated by	RBI + BR Act	RBI Act
Issue of Cheque Facility	Yes	No
Part of Payment System	Yes	No

Conclusion:

Because NBFCs cannot provide cheque facilities, they are *not* considered banks under Section 5(b).

1.13 Why the Definition Was Needed

Before the Act, many companies misused the term “bank” without performing real banking functions. This created:

- Public confusion
- Financial fraud
- Loss of depositor confidence

The legal definition ensures that only genuine institutions offering complete banking services can call themselves “banks”.

1.14 Meaning of “Banking Company” (Section 5(c))

A **banking company** means any company which **transacts the business of banking** in India.

Key features:

- Must be registered under Companies Act
- Must hold RBI license
- Must follow BR Act rules

Foreign banks operating in India (HSBC, Citibank, Standard Chartered) are also treated as banking companies.

1.15 Significance of the Definition in Regulation

The definition is not just a description—it is a **legal foundation** that determines:

- Applicability of RBI rules
- What institutions can be regulated
- Which companies need banking licenses
- Which companies can use the word “bank” in their name

If any institution does not fulfill this definition, RBI can legally:

- Deny license
- Cancel operations
- Stop misuse of the term "bank"

1.16. Illustrations and Examples

Example 1:

A company accepts money from members only and offers a fixed return.

→ **Not a bank**

(Does not accept deposits from the public)

Example 2:

An NBFC accepts deposits for 1 year.

→ **Not a bank**

(Cannot issue cheques)

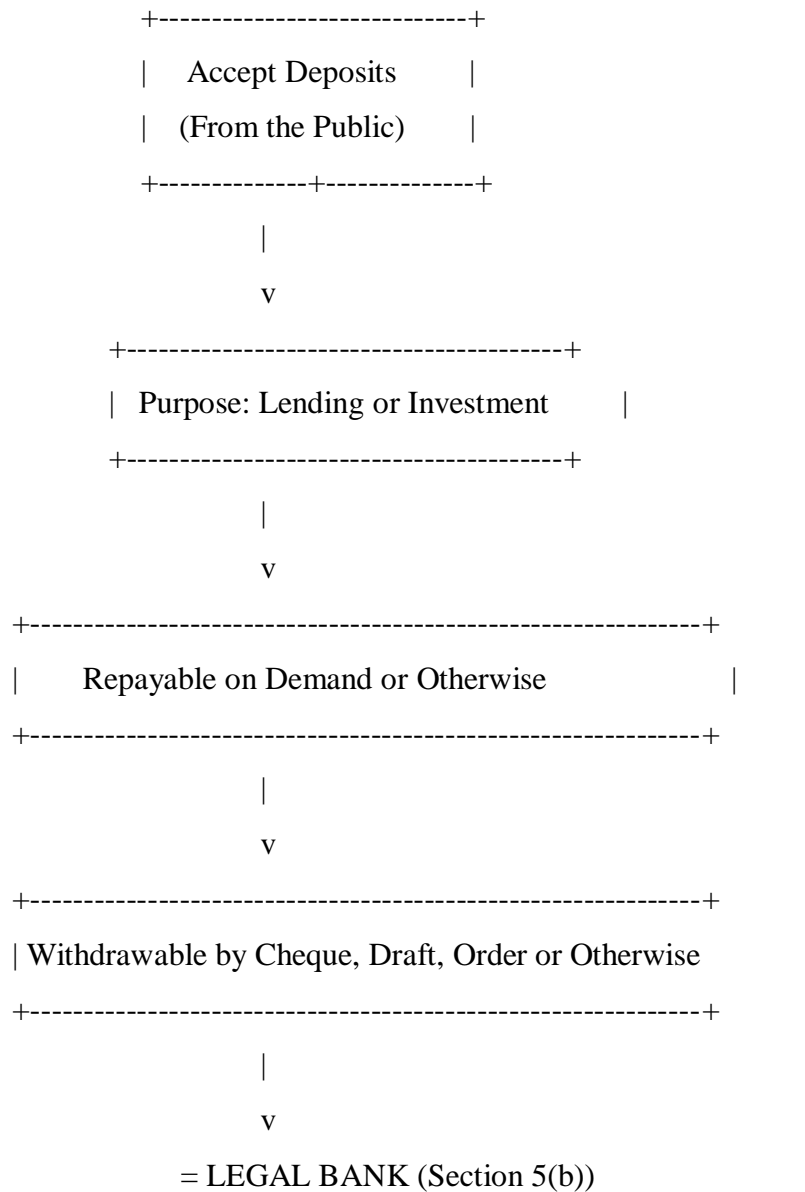
Example 3:

A bank accepts deposits, lends loans, and customers withdraw money using cheques.

→ **Bank**

(Fulfills all requirements)

1.17. Diagrammatic Representation of Definition



LICENSING OF BANKS & OPENING OF BRANCHES

(Section 22 & 23 of the Banking Regulation Act, 1949)

1.18. LICENSING OF BANKS (SECTION 22)

Introduction

Licensing is one of the most important legal requirements for banking operations in India. Banking is a business that directly deals with public money; therefore, only institutions that meet strict standards are allowed to function as banks.

Under Section 22 of the Banking Regulation Act, 1949, no company can carry on banking business in India without a license issued by the Reserve Bank of India (RBI).

This rule applies to:

- Newly formed banks
- Existing banks
- Foreign banks operating in India
- Cooperative banks (with amendments)

The licensing requirement enables RBI to maintain control over the number, quality, and reliability of banking institutions in the country.

1.19. Why Is Licensing Necessary?

Licensing acts as a **gatekeeping tool** to ensure that only qualified, financially sound, and well-managed institutions can enter the banking sector.

Importance of Licensing

1. Protects Depositors' Interests

Ensures new banks will not misuse public funds.

2. Prevents Unhealthy Competition

Too many poorly managed banks can destabilize the system.

3. Ensures Adequate Capital & Infrastructure

Banks must have sufficient financial base before starting operations.

4. Ensures Compliance with Regulations

Only institutions agreeing to follow RBI rules are granted licenses.

5. Promotes Professional Management

RBI evaluates the competence of promoters and directors.

6. Maintains Financial Stability

Prevents fraudulent or weak institutions from entering the market.

1.20. Conditions for Granting a Banking License

Before granting a license, RBI conducts a detailed examination of the applicant bank. The Act empowers RBI to be strict, because banking involves public money.

RBI examines:

1. Financial Soundness

- Adequate **capital structure**
- Stable financial resources
- Ability to absorb losses

2. Promoters' Background

- Experience in finance

- Integrity and reputation
- Professional competence

3. Public Interest

The proposed bank must serve:

- Public needs
- Financial inclusion
- National objectives

4. Future Earnings Potential

RBI ensures the bank will be able to:

- Grow sustainably
- Operate profitably
- Meet long-term obligations

5. Management Quality

- Board of Directors must be fit and proper
- CEO must be professionally qualified

6. Adequacy of Infrastructure

- Proper office setup
- Technological capability
- Security systems

7. Compliance with Law

The applicant must agree to:

- Maintain CRR and SLR

- Follow priority sector norms
- Submit regular reports

1.21. Types of Banking Licenses in India

A. Universal Bank License

Allows full banking operations:

Deposits, loans, foreign exchange, investments, etc.

(Example: SBI, HDFC, ICICI)

B. Small Finance Bank License

Focuses on unserved and underserved sections.

(Example: AU Small Finance Bank)

C. Payments Bank License

Allows deposits up to a limit but **no lending**.

(Example: Paytm Payments Bank, India Post Payments Bank)

D. Foreign Bank License

Mandatory for international banks wishing to operate in India.

1.22. Procedure for Obtaining a Banking License

Step 1: Submission of Application to RBI

Application includes:

- Business plan
- Capital structure
- Background of promoters
- Organizational structure

Step 2: Primary Scrutiny

RBI checks basic eligibility.

Step 3: Detailed Evaluation

Assessment of:

- Financial strength
- Risk management systems
- Promoters' history

Step 4: In-Principle Approval

If satisfied, RBI grants **in-principle license**, usually valid for 18 months.

Step 5: Fulfillment of Conditions

Applicant must satisfy conditions laid down by RBI.

Step 6: Final License Issued

Operations may commence after receiving written permission.

1.23. Grounds for Refusal or Cancellation of License

RBI may **refuse** to grant a license if:

- Bank lacks financial strength
- Promoters lack integrity
- Business plan is weak

- Public interest is not served

RBI may **cancel** a license if:

- Bank violates rules
- Bank stops operations for 6 months
- Bank fails to maintain required capital
- Bank engages in fraudulent activities

1.24. Licensing of Foreign Banks (Section 22A)

Foreign banks must also obtain RBI's permission before operating in India.

Additional requirements include:

- Compliance in home country
- Adequate global capital
- Commitment to abide by Indian laws

Examples: HSBC, Citi, Standard Chartered.

1.25. OPENING OF BRANCHES (SECTION 23)

Introduction

Banks expand their reach by opening new branches—rural, semi-urban, urban, or metropolitan. The Banking Regulation Act ensures that such expansion happens in a controlled and beneficial manner.

Under Section 23:

No bank can open a new branch or shift an existing one without RBI's prior approval.

This is essential to maintain orderly growth and to ensure banking services reach all corners of the country, especially rural areas.

1.26. Why Is RBI Involved in Branch Expansion?

Without regulation, banks would only open branches in profitable urban areas.

RBI regulates branch opening to:

1. Reduce Regional Imbalance

Encourage banks to open branches in:

- Rural villages
- Remote areas
- Financially backward regions

2. Promote Financial Inclusion

More branches = more people covered under formal banking.

3. Maintain Banking Discipline

Avoid excessive concentration of banks in certain areas.

4. Ensure Sustainable Expansion

Branches should be:

- Economically viable
- Properly staffed
- Equipped with infrastructure

5. Maintain Public Convenience

Branches must be located where people actually need banking services.

1.27. What is a “Branch”? (Meaning under the Act)

A branch includes:

- Full-service branch
- Extension counter
- Satellite office
- Mobile branch
- ATM
- Service branch
- Regional processing centre

Essentially, any place where banking business is conducted is considered a “branch”.

1.28. Conditions for Opening a Branch

Before granting permission, RBI examines:

1. Financial strength of the bank

Bank must be capable of supporting new operational costs.

2. Need for banking facilities in the area

RBI studies:

- Population
- Economic activity
- Banking penetration

3. Past performance of the bank

Banks with strong compliance records are favored.

4. Bank’s policy on financial inclusion

RBI prefers banks committed to rural development.

5. Technological readiness

To ensure efficient service delivery.

1.29. The Branch Authorization Policy

RBI follows a structured policy called the **Branch Authorization Policy**, which requires banks to:

- Open at least **25%** of new branches in **unbanked rural areas**
- Submit an annual branch expansion plan
- Follow guidelines for ATMs, mobile branches, and micro-offices

This ensures equitable distribution of banking services.

1.30. Procedure for Opening a Branch

Step 1: Submission of Proposal

Bank submits:

- Location details
- Type of branch
- Expected business
- Infrastructure plan

Step 2: RBI Evaluation

RBI analyzes:

- Area's banking needs
- Bank's financial status
- Prior compliance record

Step 3: Approval Granted

If satisfied, RBI issues a written permission.

Step 4: Setting Up the Branch

Bank arranges:

- Staffing
- Furniture, computers, communications
- Security systems
- Cash safes and vaults

Step 5: Branch Commences Operations

1.31. Shifting or Closing Branches

Banks cannot shift or close branches without RBI permission.

Reasons:

- Customers must not be inconvenienced
- Local banking needs must be protected

ATMs can be shifted more freely but still require adherence to certain guidelines.

1.32. Foreign Banks – Branch Rules

Foreign banks require **additional approvals** for opening branches.

RBI considers:

- Home country regulations
- International reputation
- Global financial strength

Foreign banks often open:

- Representative offices
- NRI service branches
- Trade finance wings

1.33. Benefits of Regulated Branch Expansion

For Banks

- Planned growth
- Better market presence
- Reduced risks

For the Economy

- Regional development
- Increased employment
- Improved financial literacy

For People

- Access to formal banking
- Safer savings
- Availability of loans

FUNCTIONS OF BANKS (DETAILED EXPLANATION)

CHAPTER 6: FUNCTIONS OF BANKS – INTRODUCTION

Banks play a crucial role in the economic structure of a country. Their operations are not limited to just accepting deposits and granting loans. In the modern financial system, banks perform many additional functions such as remittance services, digital banking, investment services, credit card facilities, and acting as trustees and advisors.

The Banking Regulation Act requires banks to carry out activities in a safe and regulated manner.

The functions of banks can be divided into **three major categories**:

1. Primary Functions

- Accepting Deposits
- Lending of Money

2. Secondary Functions

- Agency Functions
- General Utility Functions

3. Modern/Innovative Functions

- Digital Banking
- Electronic Fund Transfer
- Internet/Mobile Banking
- ATM, Debit, and Credit Card Services

These functions make banks the backbone of economic and financial operations.

PART A: PRIMARY FUNCTIONS OF BANKS

Primary functions are the most essential banking activities. A bank cannot operate without performing these functions.

1.34. Accepting Deposits

Accepting deposits is the **core function** of a bank. Deposits are the major source of funds for banks. They indicate the trust customers have in the banking system.

Why do people deposit money in banks?

- Safety: Protection from theft or loss
- Convenience: Easy withdrawals
- Interest: Savings generate small returns
- Transaction needs: Payment of bills, transfers
- Record-keeping: Proof of financial activities

1.35. Types of Deposits

A. Demand Deposits

These are deposits withdrawable whenever the customer desires.

1. Savings Bank Deposit

- Designed for individuals
- Encourages savings
- Offers moderate interest
- Withdrawal allowed through cheque, ATM, or online banking

Best for: salaried persons, students, small savers.

2. *Current Account Deposit*

- Mainly for businesses and traders
- No limit on number of withdrawals
- No interest paid
- Overdraft facility available

Best for: companies, firms, retailers.

B. Time Deposits (Term Deposits)

These deposits are repayable after a fixed term.

1. *Fixed Deposit (FD)*

- Deposited for a specific period (7 days to 10 years)
- Higher interest rate than savings account
- Premature withdrawal allowed with penalty

Example: Investor deposits ₹1, 00,000 for 2 years at 6%.

2. *Recurring Deposit (RD)*

- Deposit made monthly
- Suitable for small savers
- Interest similar to fixed deposits

Example: Student saving ₹500 per month.

3. *Special Deposit Schemes*

- Tax-saving FD
- Senior citizen deposit plans
- Monthly income schemes

6.2 Lending of Funds

Lending is the **second primary function**. Banks use the money collected from depositors to give loans and advances.

Why do banks lend?

- To earn interest (main income source)
- To promote trade, industry, agriculture
- To support economic development

1.36. Types of Loans and Advances

A. Loans

- Given for a fixed amount
- Repayable in instalments or lump sum
- Long-term loans available

Examples: home loans, vehicle loans, personal loans.

B. Overdraft

- Allowed to current account holders
- Withdrawal permitted beyond account balance
- Interest charged only on the amount used

Example: Trader can withdraw ₹50,000 even if account has ₹10,000.

C. Cash Credit

- Borrowers allowed to withdraw up to a sanctioned limit
- Secured against stock, goods, or receivables
- Flexible and widely used by businesses

D. Discounting of Bills

- Banks buy bills of exchange before maturity
- Immediate cash provided
- Bank charges discount

Used by: wholesalers, exporters, manufacturers.

E. Consumer Loans

- Used for buying household goods, electronics, etc.

F. Agricultural Loans

- For farmers: crop loans, irrigation loans, tractor loans.

G. Priority Sector Lending

Banks must lend to:

- Agriculture
- MSMEs
- Education
- Housing for poor
- Socially important sectors

PART B: SECONDARY FUNCTIONS OF BANKS

Secondary functions complement primary banking functions and improve usefulness to customers.

1.37. Agency Functions

Banks act as **agents** on behalf of customers and perform various services.

1. Collection of Cheques and Bills

Banks collect:

- Cheques
- Drafts
- Bill payments

2. Payment of Bills

Banks pay:

- Electricity bills
- Telephone bills
- Insurance premiums

3. Collection of Dividends and Interest

Banks collect:

- Interest on bonds
- Dividends on shares

4. Purchase and Sale of Securities

Banks buy and sell:

- Shares
- Debentures
- Mutual funds

5. Acts as Trustee or Executor

Banks manage wills and trusts.

6. Remittance of Money

Banks send money through:

- Drafts
- NEFT
- RTGS
- IMPS

1.38. General Utility Functions

General utility functions enhance customer convenience.

1. Safe Deposit Lockers

Banks provide lockers to store valuables.

2. Issue of Letters of Credit

Used in international trade.

3. Issue of Traveller's Cheques

For travel safety.

4. Underwriting

Banks underwrite shares or debentures.

5. Merchant Banking

Banks provide consultation for:

- Project reports
- Feasibility analysis
- Capital issues

6. Credit Cards

Banks issue credit cards enabling cashless payments.

7. Consultancy Services

Banks advise clients on investments, taxes, and savings.

8. ATM Services

Provide:

- Cash withdrawal
- Balance enquiry
- Mini statements

PART C: MODERN FUNCTIONS OF BANKS

Due to technological advancement, banks have adopted new methods of service delivery.

1.39. Digital and Electronic Banking

1. Internet Banking

Customers can:

- View balance
- Transfer funds
- Make bill payments
- Request statements

Advantages:

- 24/7 access
- No need to visit branch
- Paperless banking

2. Mobile Banking

Through smartphone apps, customers can:

- Pay bills
- Transfer funds
- Scan & pay via QR

3. ATM Services

ATMs allow:

- Cash withdrawal
- PIN change
- Mini statements
- Fund transfer (in some ATMs)

4. Debit Cards

Withdraw money directly from account.

5. Credit Cards

Borrow money up to a limit.

6. Electronic Fund Transfer (EFT)

Used for:

- Salary payments
- Vendor payments

7. RTGS, NEFT, IMPS

- **RTGS:** Real-time, large amounts
- **NEFT:** Batch-based settlement
- **IMPS:** Instant 24/7
- **UPI:** Mobile-based instant transfer

8. Electronic Clearing Service (ECS)

Used for:

- EMI
- Monthly bills
- Dividend payments

9. Digital Wallets

Banks provide apps:

- YONO
- iMobile
- HDFC PayZapp

6.6 Role of Banks in Economic Development

Banks promote:

- Industrial growth
- Agricultural development
- Trade and commerce
- Infrastructure development
- Entrepreneurship
- Employment generation

Banks also:

- Maintain financial stability
- Mobilize savings
- Support government policies

1.40. Comparison: Traditional vs. Modern Banking

Traditional Banking	Modern Banking
Manual operations	Automated systems
Paper-based transactions	Digital transactions
Branch-dependent	24/7 online access
Limited services	Multiple financial products
Slow processing	Instant transfers

1.41. INSPECTION OF BANKS – INTRODUCTION

Bank inspection is an important regulatory mechanism through which the Reserve Bank of India ensures that banks operate safely, efficiently, and in compliance with established laws and guidelines. Since banks handle **public deposits**, ensuring their financial health is essential to maintaining trust in the financial system.

Under Section 35 of the Banking Regulation Act, 1949, the Reserve Bank of India (RBI) has the legal authority to conduct inspection of banks at any time it deems necessary, either directly or through authorized officers.

Bank inspection is a powerful supervisory tool that enables RBI to:

- Detect irregularities
- Prevent fraud
- Ensure compliance
- Maintain financial stability
- Protect depositors' interests

1.42. Meaning of Inspection

Inspection refers to the systematic examination of a bank's books, accounts, operations, management, and financial condition by RBI or authorized persons.

It includes:

- Checking loan quality
- Verifying asset values
- Examining liquidity
- Ensuring compliance with RBI directives
- Assessing management efficiency

Inspection is different from routine audit. While audit focuses on financial accuracy, inspection focuses on regulatory compliance and safety of banking operations.

1.42. Objectives of Bank Inspection

The primary objectives of RBI's bank inspection are:

1. Protecting Depositors' Interests

To ensure banks are financially sound and capable of returning depositors' money without risk.

2. Ensuring Compliance

Banks must follow:

- Banking Regulation Act
- RBI Act
- KYC norms
- Basel norms
- Prudential guidelines

3. Preventing Fraud

Inspection detects:

- Manipulation of accounts
- Fake loans
- Insider abuse
- Money laundering

4. Assessing Quality of Assets

Identifying Non-Performing Assets (NPAs) is a major part of inspection.

5. Checking Liquidity Position

Banks must maintain CRR, SLR, and adequate cash reserves.

6. Evaluating Management Quality

RBI examines:

- Efficiency
- Integrity
- Professionalism

7. Ensuring Healthy Banking System

Inspection ensures stability, safety, and public confidence in the banking sector.

1.43. Legal Basis for Inspection (Section 35)

Section 35 authorizes RBI to:

a) Conduct inspections of any banking company

RBI may inspect:

- Accounts
- Books
- Records

- Branches

b) Appoint officials for inspection

Inspections may be carried out by:

- RBI officers
- Chartered accountants
- External experts authorized by RBI

c) Inspect foreign banks' branches in India

RBI has complete authority over their Indian operations.

d) Access any information during inspection

Banks must produce:

- Books
- Receipts
- Vouchers
- Ledgers
- Minutes of meetings

e) Submit inspection report to Central Government (if needed)

If major violations are found, RBI informs the government.

1.44. Types of Bank Inspection Conducted by RBI

There are several types of inspections, each with a specific purpose.

1. On-Site Inspection

Carried out at the bank's premises. RBI officers visit branches and head office to review records.

Focus Areas:

- Loan portfolio
- Asset quality
- Capital adequacy
- Liquidity position
- Profitability
- Fraud detection

This is the most comprehensive inspection.

2. Off-Site Monitoring

RBI monitors banks based on periodic reports submitted by them.

Reports include:

- Assets and liabilities
- Loan performance
- Profitability statements
- Compliance certificates

This is faster and less disruptive than on-site inspection.

3. Targeted / Thematic Inspection

Conducted to examine specific issues such as:

- KYC violations
- Fraud in branches
- Irregular loans
- Cybersecurity weaknesses

4. Cybersecurity and ITS Inspection

Modern banks rely heavily on IT systems. RBI inspects:

- Data security
- IT infrastructure
- Digital fraud protection
- Online banking operations

5. Risk-Based Supervision (RBS)

Latest inspection model, focusing on:

- Risk management systems
- Market risk
- Operational risk
- Credit risk

Banks with high-risk profiles receive stricter supervision.

1.45. Procedure for Conducting Inspection

The inspection process generally follows the steps below:

Step 1: Notice Issued

RBI informs the bank in advance about scheduled inspection.(However, surprise inspections are also possible.)

Step 2: Collection of Preliminary Data

Banks must provide:

- Financial statements
- Management reports
- Risk assessments
- Loan registers

- KYC documents

Step 3: On-Site Examination

RBI officials examine:

- Books of accounts
- Loan files
- Security documents
- Cash balances
- Customer complaints
- IT systems

Step 4: Discussion with Management

RBI interacts with:

- CEO
- Chief risk officer
- Senior branch managers
- Credit officers

Purpose: Clarify issues, understand management decisions.

Step 5: Identification of Weaknesses

Weaknesses may include:

- High NPAs
- Improper loan sanctioning
- Non-compliance with guidelines
- Liquidity shortages
- Fraud indicators

Step 6: Preparation of Inspection Report

A detailed report is prepared, containing:

- Observations
- Violations
- Risk areas
- Recommendations

This report is confidential.

Step 7: Corrective Action by Bank

The bank must:

- Rectify errors
- Improve compliance
- Strengthen internal controls

RBI monitors the corrective measures.

1.46. Focus Areas of Inspection

RBI focuses on certain critical areas to ensure safety and stability.

1. Capital Adequacy (CRAR)

Whether the bank has enough capital to absorb losses.

2. Asset Quality

Examines NPAs, loan risks, and recovery practices.

3. Management Quality

Assesses:

- Leadership integrity

- Decision-making
- Internal controls

4. Earnings and Profitability

Reviews:

- Income sources
- Expense patterns
- Financial performance

5. Liquidity

Ensures the bank can meet short-term obligations.

6. Sensitivity to Market Risk

Checks foreign exchange risk, interest rate risk, and investment risk.

(These are collectively known as CAMELS – Capital, Asset Quality, Management, Earnings, Liquidity & Sensitivity.)

1.47. Rights and Duties of the RBI during Inspection

RBI's Rights

- Full access to bank's records
- Question any employee
- Inspect any branch
- Demand explanations
- Examine IT systems

RBI's Duties

- Maintain confidentiality

- Follow fair procedures
- Provide recommendations
- Ensure constructive feedback

1.48. Consequences of Adverse Inspection Reports

If RBI finds serious irregularities, it may:

1. Issue Directions

Bank must follow instructions to improve conditions.

2. Impose Penalties

Financial penalties for violations.

3. Restrict Business Operations

Example:

- Stop new loans
- Restrict branch expansion

4. Change Management

Direct removal of unfit directors or managers.

5. Initiate Merger or Amalgamation

Weak banks may be merged.

6. Cancel Bank's License

In extreme cases, under Section 22.

Inspection acts as a preventive measure before violations worsen.

1.49. Importance of Bank Inspection

A. For the Banking System

- Prevents collapse
- Ensures sound practices
- Enhances stability

B. For RBI

- Helps in regulatory supervision
- Ensures monetary policy effectiveness

C. For Depositors

- Protects money
- Builds trust
- Ensures fair services

D. For Economy

- Prevents financial crises
- Promotes economic development

INTRODUCTION TO RESERVE BANK OF INDIA

The **Reserve Bank of India (RBI)** is the central banking institution of India. It acts as the apex monetary authority, responsible for maintaining financial stability, regulating banks, issuing currency, managing foreign exchange, and supporting economic growth.

RBI is the bankers' bank, bank to the government, custodian of foreign reserves, and the controller of credit in the economy.

1.50. Establishment of RBI – Historical Background

Origin

Before the establishment of RBI, India did not have a central bank. Money supply, monetary policy, and currency issues were handled by different agencies including the Imperial Bank of India (now SBI) and the Government of India.

Due to growing economic complexity and the need for a unified monetary authority, the **Hilton Young Commission** (also known as **Royal Commission on Indian Currency and Finance**) recommended establishing a central bank.

Legal Foundation

The RBI was established under the:

- **Reserve Bank of India Act, 1934**

Dates to Remember

Event	Date
RBI Act Passed	1934
RBI Established	1 April 1935
Headquarters (initial)	Kolkata
Shifted to	Mumbai (1937)
Nationalisation	1 January 1949

RBI was originally a private shareholders' bank but was nationalized in 1949 after India gained independence to align monetary policy with national goals.

1.51. Objectives of RBI

The RBI Act outlines the central objectives of RBI:

1. To Regulate the Issue of Currency

To ensure adequate supply of money and maintain public confidence.

2. To Maintain Monetary Stability

Control inflation and ensure stable prices.

3. To Promote Economic Growth

Support agriculture, industry, and trade through credit policies.

4. To Manage the Country's Foreign Exchange

Through the Foreign Exchange Management Act (FEMA).

5. To Act as Banker's Bank

Supervise and regulate commercial banks.

6. To Act as Banker to Government

Manage banking transactions of Central and State governments.

7. To Promote Financial Inclusion

Bring unbanked populations into formal finance.

8. To Ensure Financial Stability

Prevent bank failures and protect depositors.

1.52. Organisation & Structure of RBI

The organisational structure of RBI ensures professional management and effective supervision.

Central Board of Directors

The central authority of RBI is the Central Board of Directors, appointed by the Government of India.

Composition:

1. One Governor
2. Up to Four Deputy Governors
3. Four Directors nominated from local boards
4. Ten Directors from different fields (finance, agriculture, industry)
5. Two Government Officials
6. Local Boards for regional representation (Mumbai, Kolkata, Chennai, New Delhi)

1.53. Governor and Deputy Governors

Governor

The Governor is the **chief executive** of RBI and has the ultimate authority in policy decisions.

Role of Governor

- Head of RBI
- Issues monetary policy
- Oversees currency issuance
- Regulates the banking system
- Represents RBI internationally

Deputy Governors

Usually four in number, their functions include:

- Banking regulation

- Currency management
- Financial markets
- Foreign exchange department

Other key officials include:

- Executive Directors
- Chief General Managers
- Regional Directors

1.54. Departments of RBI

RBI operates through numerous specialized departments:

Key Departments

- **Department of Banking Regulation (DBR)**
- **Department of Banking Supervision (DBS)**
- **Monetary Policy Department (MPD)**
- **Issue Department** (currency distribution)
- **Foreign Exchange Department (FED)**
- **Consumer Education and Protection Department (CEPD)**
- **Financial Market Operations Department (FMOD)**
- **Internal Debt Management Department (IDMD)**

Each department plays a specific role in managing the financial ecosystem.

1.55. RBI Offices and Branch Network

- Central Office: Mumbai
- Regional Offices: Located in major cities (Delhi, Chennai, Kolkata, Bengaluru, Hyderabad, etc.)
- Sub-offices: Smaller cities
- Currency Chests: Held with commercial banks under RBI supervision

- Depositories: For storing government securities

FUNCTIONS OF RESERVE BANK OF INDIA

RBI performs numerous traditional and modern functions.

These are classified as:

A. Traditional Functions

B. Developmental Functions

C. Promotional Functions

D. Supervisory Functions

A. TRADITIONAL FUNCTIONS OF RBI

1.56. Issue of Currency (Sole Right)

RBI has the monopoly of issuing currency notes (except ₹1 note and coins which are issued by the Government of India but circulated by RBI).

Purpose of Currency Issue:

- Maintain public confidence
- Ensure uniformity in currency
- Prevent counterfeiting
- Control money supply

System of Note Issue

RBI follows the **Minimum Reserve System**:

- Must maintain a minimum reserve of **₹200 crore**, including
 - ₹115 crore in gold

- Balance in foreign currencies

1.57. Banker to Government

RBI acts as the banker, agent, and financial advisor to both Central and State Governments.

Functions:

- Maintains government accounts
- Manages public debt
- Handles tax receipts and payments
- Helps in capital raising (government securities)
- Advises government on economic policy

1.58. Banker's Bank

RBI supervises banks and provides financial support when needed.

Services to Banks:

- Accepts deposits from banks
- Provides loans and advances
- Maintains CRR (Cash Reserve Ratio)
- Acts as clearing house

RBI ensures smooth interbank transactions.

1.59. Controller of Credit (Monetary Authority)

One of the most important functions. RBI controls the quantity and direction of credit in the economy through monetary instruments like:

- Bank Rate
- Open Market Operations
- Repo, Reverse Repo

- CRR, SLR
- Marginal Standing Facility

1.60. Custodian of Foreign Exchange

Under **FEMA (1999)**, RBI manages foreign exchange reserves and facilitates international trade by:

- Regulating FOREX market
- Maintaining exchange rate stability
- Managing India's foreign currency reserves

1.61. Banker to Banks (Clearing House)

RBI acts as a clearing house:

- Settles cheques
- Ensures quick settlement
- Reduces the need for physical cash movement

The introduction of **RTGS, NEFT, UPI, and IMPS** has modernized clearing operations.

1.62. Controller of Banking System (Regulator)

RBI regulates the entire banking sector by:

- Issuing licenses
- Approving branch expansion
- Setting capital norms
- Conducting inspections
- Monitoring banks through Off-site Surveillance

The Banking Regulation Act empowers RBI to maintain discipline across banks.

B. DEVELOPMENTAL FUNCTIONS OF RBI

These functions are aimed at promoting economic development.

Development of Agriculture and Rural Sector

RBI helped establish:

- **NABARD** (National Bank for Agriculture and Rural Development)
- Refinancing schemes for farm credit
- Priority sector lending norms

RBI's efforts support:

- Rural infrastructure
- Microfinance
- SHGs and cooperative banks

Development of Industry

RBI supports industrial growth through:

- Refinance facilities
- Industrial finance institutions
- Support to MSMEs
- Credit Guarantee Schemes

Development of Financial System

RBI played a key role in:

- Establishing SEBI
- Creating money market and capital market reforms
- Introducing payment systems
- Digital banking
- Licensing new types of banks (SFBs, Payments Banks)

C. PROMOTIONAL FUNCTIONS

Financial Inclusion Initiatives

RBI promotes financial inclusion through:

- No-frills accounts
- PM-JDY support
- Business Correspondent (BC) model
- Encouraging mobile and digital banking
- Customer protection guidelines

Consumer Education and Protection

RBI ensures customers are treated fairly by:

- Ombudsman scheme
- Grievance redressal
- Standardized disclosure of charges
- Protection against fraud

D. SUPERVISORY FUNCTIONS

Regulation and Supervision of Banks

RBI supervises banks through:

- Licensing
- Inspections (Section 35)
- Monitoring NPAs
- Prudential norms
- Prompt Corrective Action (PCA) framework
- Basel III guidelines

Regulation of NBFCs

RBI controls Non-Banking Financial Companies by ensuring:

- Minimum capital requirement
- Governance norms
- Fair practices code
- Prevention of fraud

Exchange Control

Under FEMA, RBI regulates:

- Foreign investments
- External borrowings
- Export and import payments
- International remittances

ROLE OF RBI IN INDIAN ECONOMY

RBI's role is multi-dimensional.

RBI as Monetary Authority

Controls inflation, money supply, and interest rates.

RBI as Protector of Depositors

Ensures banks are financially strong.

RBI as Financial Sector Stabilizer

Manages crises and prevents bank failures.

RBI as Promoter of Payment Systems

Developed:

- NEFT
- RTGS
- UPI
- Bharat BillPay

RBI in Digital Transformation

Promotes:

- Digital rupee (CBDC)
- Fintech innovations
- Secure digital payments

CREDIT CONTROL MECHANISMS OF RBI (MONETARY POLICY)

Credit control is one of the **most important functions of the Reserve Bank of India (RBI)**. It refers to the **regulation of credit flow in the economy** to ensure price stability, economic growth, and financial stability.

Definition

“Credit control refers to the methods employed by the central bank to regulate the volume, direction, and cost of credit in the economy.”

RBI exercises credit control primarily to:

- Prevent inflation or deflation
- Promote economic growth
- Ensure availability of credit to priority sectors
- Maintain financial stability

Objectives of Credit Control

1. **Price Stability** – Control inflation and deflation.
2. **Economic Development** – Ensure credit availability to agriculture, industry, and trade.
3. **Financial Stability** – Protect banks from excess lending or liquidity crises.
4. **Regulation of Money Supply** – Control overall money in circulation.
5. **Encourage Priority Sector Lending** – Agriculture, MSMEs, education, housing.
6. **Maintain Public Confidence** – Avoid financial crises.

Types of Credit Control

RBI uses **two broad categories** of credit control:

Type	Purpose
Quantitative / General	Controls the volume of credit in the economy.
Qualitative / Selective	Controls the direction and purpose of credit.

A. QUANTITATIVE METHODS OF CREDIT CONTROL

Quantitative or general credit control affects **all sectors of the economy uniformly**. It focuses on **regulating the amount of credit** banks can create.

Methods of Quantitative Credit Control

1. Bank Rate Policy
2. Open Market Operations (OMO)
3. Cash Reserve Ratio (CRR)
4. Statutory Liquidity Ratio (SLR)
5. Repo and Reverse Repo Rate

Bank ate Policy

- Bank rate = Rate at which RBI lends to commercial banks for long-term credit.

- Increase in bank rate: Credit becomes costlier → borrowing decreases → inflation controlled.
- Decrease in bank rate: Credit becomes cheaper → borrowing increases → growth stimulated.

Example: If inflation is rising, RBI may raise bank rate from 6% to 6.5% to reduce borrowing.

Open Market Operations (OMO)

- Buying or selling government securities in the open market.
- Sale of securities: Absorbs excess liquidity → reduces credit → controls inflation.
- Purchase of securities: Releases liquidity → increases credit → stimulates growth.

OMO is a **flexible and short-term tool**.

Cash Reserve Ratio (CRR)

- Definition: Minimum % of net demand & time liabilities (NDTL) that banks must keep with RBI.
- Purpose: Control liquidity.
- Increase in CRR: Banks have less money → credit reduces → inflation controlled.
- Decrease in CRR: Banks have more money → credit increases → growth encouraged.

Example: CRR increased from 4% → 4.5% to absorb liquidity.

Statutory Liquidity Ratio (SLR)

- Definition: Minimum % of NDTL banks must maintain in liquid assets (gold, approved govt. securities).
- Purpose: Ensure banks invest in safe assets and control lending.
- Increase in SLR: Banks lend less → credit reduces → inflation controlled.
- Decrease in SLR: Banks lend more → credit increases → economy stimulated.

Repo and Reverse Repo Rates

- Repo Rate: Rate at which banks borrow from RBI by pledging securities.
- Reverse Repo Rate: Rate at which RBI borrows money from banks.

Effects:

- Increase in Repo Rate: Credit expensive → borrowing decreases → inflation reduces.
- Decrease in Repo Rate: Credit cheaper → borrowing increases → growth promoted.
- Increase in Reverse Repo: Banks park more funds → liquidity absorbed → inflation controlled.

Repo and Reverse Repo are **short-term liquidity tools** in monetary management.

B. QUALITATIVE METHODS OF CREDIT CONTROL

Qualitative or selective credit control focuses on **directing credit to specific sectors** and **controlling its use**.

Methods of Qualitative Credit Control

1. Credit Rationing / Credit Ceiling
2. Margin Requirements
3. Consumer Credit Regulation
4. Directives / Moral Persuasion

Credit Rationing / Credit Ceiling

- RBI can limit the amount of credit available for specific sectors.
- Prevents over-lending to speculative areas (e.g., stock market, real estate).

Example: Maximum loan to real estate sector capped at ₹X crore.

Margin Requirements

- Margin = Difference between value of security and loan amount.
- Higher margin: Bank lends less → speculative borrowing reduced.

- Lower margin: Bank lends more → growth encouraged.

Example: Loan against gold worth ₹1,00,000 at 70% margin → bank can lend ₹70,000.

Consumer Credit Regulation

- RBI can restrict credit for non-essential goods: luxury cars, expensive electronics, speculative loans.
- Helps control inflation on luxury items.

Moral / Directives / Persuasive Measures

- RBI may issue guidelines to banks to restrict or expand lending.
- Examples:
 - “Increase lending to agriculture”
 - “Limit credit to speculative markets”

Moral persuasion is non-legally binding but effective due to RBI authority.

Importance of Credit Control

1. Control Inflation – Prevent excessive money supply.
2. Ensure Economic Growth – Promote lending to productive sectors.
3. Maintain Banking Stability – Prevent overexposure of banks.
4. Financial Discipline – Encourages prudent lending practices.
5. Monetary Stability – Controls liquidity in the system.

Challenges of Credit Control

- Large informal economy → RBI has limited control
- Delay in bank compliance
- Speculative lending in financial markets
- Difficulty in monitoring sector-specific credit in small towns
- Rapid technological change → digital credit (UPI, BNPL)

Recent RBI Measures (2023–2025)

- Dynamic CRR and SLR adjustments
- Repo rate changes for inflation management
- Targeted long-term repo operations (TLTRO)
- Priority sector lending support
- Digital banking expansion
- Financial stability reports and stress testing of banks

Summary of Quantitative vs Qualitative Tools

Aspect	Quantitative	Qualitative
Objective	Control total credit	Direct credit to specific uses
Impact	Economy-wide	Sector-specific
Tools	CRR, SLR, Repo, Bank Rate, OMO	Margin requirement, Credit rationing, Moral persuasion
Nature	Indirect	Direct / Selective
Example	CRR increased → liquidity reduced	Restrict credit to stock market

CONCLUSION, ACTIVITIES, CASE STUDIES & QUESTION BANK

Topic: Banking Regulation Act, RBI, Types of Banks, and Credit Control Mechanisms

1.63. CONCLUSION / OVERVIEW

UNIT I has provided a **comprehensive introduction to the Indian banking system**, its regulation, and the role of RBI.

Key Takeaways:

1. **Banking Regulation Act, 1949**

- Defines **banking** and regulates licensing, branch opening, and inspection.
 - Provides legal authority for RBI supervision.
2. **Reserve Bank of India (RBI)**
- Apex monetary authority of India.
 - Performs **traditional, developmental, promotional, and supervisory functions**.
 - Controls credit, manages currency, and regulates banks.
3. **Inspection of Banks (Section 35)**
- Ensures **financial stability**, compliance, and depositor protection.
 - Uses **on-site and off-site inspections** and thematic inspections.
4. **Types of Banks and Banking Systems**
- **Unit Banking:** Single branch, limited area.
 - **Branch Banking:** Network of branches, facilitates large-scale operations.
 - **Commercial Banks:** Accept deposits, lend money, offer services.
 - **E-banking:** Modern tools like ATM, debit cards, online transfers.
5. **Credit Control / Monetary Policy**
- **Quantitative tools:** CRR, SLR, Bank Rate, Repo/Reverse Repo, OMOs.
 - **Qualitative tools:** Margin requirements, credit rationing, moral persuasion.

STUDENT ACTIVITIES / EXERCISES

Activity 1: Role Play – RBI Inspection

- **Objective:** Understand the inspection process.
- **Instructions:**
 1. Divide into 3 groups: RBI Inspectors, Bank Management, Customers.
 2. RBI Inspectors check accounts and ask for explanations.
 3. Bank Management responds and presents corrective measures.
 4. Customers note how their interests are protected.
- **Outcome:** Students simulate real bank inspection and learn practical aspects of Section 35.

Activity 2: Debate – Quantitative vs Qualitative Credit Control

- **Objective:** Understand advantages and limitations of both tools.

- **Instructions:**
 1. Divide into two teams: Team A supports Quantitative tools; Team B supports Qualitative tools.
 2. Discuss effectiveness in controlling inflation, promoting priority sector lending, and ensuring stability.
- **Outcome:** Students critically analyze RBI tools and policy measures.

Activity 3: Case Study – Bank Merger / Failure

- **Objective:** Understand the role of RBI in maintaining financial stability.
- **Instructions:**
 1. Research a recent bank merger or RBI intervention (e.g., Yes Bank crisis 2020).
 2. Prepare a report covering RBI inspection, directives, and corrective action.
- **Outcome:** Students learn real-world application of RBI powers and depositor protection.

Activity 4: Group Presentation – Digital Banking

- **Objective:** Explore modern banking technologies.
- **Instructions:**
 1. Assign topics like ATM, UPI, NEFT, RTGS, Digital Rupee.
 2. Students explain functionality, benefits, and risks.
- **Outcome:** Students gain hands-on understanding of digital banking.

CHAPTER 15: UNIT I QUESTION BANK

A. Objective / Multiple Choice Questions

1. In which year was the Banking Regulation Act enacted?
 - a) 1934
 - b) 1949
 - c) 1956
 - d) 1969

2. Which section of the Banking Regulation Act authorizes RBI to inspect banks?
 - a) Section 22
 - b) Section 35
 - c) Section 45
 - d) Section 58
3. Repo rate refers to:
 - a) Rate at which RBI lends to commercial banks
 - b) Rate at which banks lend to customers
 - c) Rate at which RBI borrows from banks
 - d) None of the above
4. Which of the following is a qualitative credit control method?
 - a) CRR
 - b) SLR
 - c) Margin requirement
 - d) Bank Rate

B. Short Answer Questions

1. Explain the main objectives of RBI.
2. What are the functions of commercial banks in India?
3. Differentiate between unit banking and branch banking.
4. Define cash reserve ratio (CRR) and its importance.
5. Describe the role of RBI as a banker to the government.

C. Long Answer / Essay Questions

1. Discuss the salient features of the Banking Regulation Act, 1949.
2. Explain the powers of RBI under Section 35 for bank inspection.
3. Elaborate on the traditional, developmental, and supervisory functions of RBI.
4. Describe quantitative and qualitative credit control measures of RBI with examples.
5. Examine the importance of bank inspections and their impact on financial stability.

D. Practical / Activity-Based Questions

1. Prepare a chart showing how Repo and Reverse Repo rates affect credit flow.
2. Conduct a mini-survey on the usage of digital banking among students and report findings.
3. Analyze a recent RBI monetary policy statement and summarize key decisions.
4. Simulate bank inspection using a fictional bank dataset and identify corrective measures.

PART 8 SUMMARY / KEY LEARNING POINTS

- UNIT I provides a **foundation for banking theory, law, and practice.**
- Students learn about:
 - Banking Regulation Act, 1949
 - RBI's powers, organization, and functions
 - Bank inspection process
 - Credit control mechanisms (quantitative and qualitative)
- Activities and case studies **enhance practical understanding.**

UNIT II

2.1 Classification by Ownership

2.2 Classification by Functions

2.3. Unit Banking

2.4. Branch Banking

2.5. Indian commercial banks

2.6. Historical Background

2.7. Functions of Commercial Banks

2.8. Nationalization of major commercial banks in india

2.9. Historical Background

2.10. Objectives of Nationalization

2.11. Impact of Nationalization

2.12. Functions of commercial banks

2.13. Secondary Functions of Commercial Banks

2.14. Banking modernization and e-banking

INTRODUCTION TO BANKS

A bank is a financial institution that accepts deposits from the public, creates credit, and provides loans and other financial services. Banks act as intermediaries between depositors and borrowers and are crucial for economic growth.

Definition of a Bank

The Banking Regulation Act, 1949 defines banking as:

"Banking means accepting, for the purpose of lending or investment, of deposits of money from the public, repayable on demand or otherwise, and withdrawable by cheque, draft, order, or otherwise."

Importance of Banks

1. Mobilization of savings – Converts individual savings into productive capital.
2. Credit creation – Provides loans to business, agriculture, and households.
3. Financial intermediation – Connects surplus and deficit units.
4. Facilitates trade and commerce – Provides payment mechanisms and trade finance.
5. Support for economic growth – Assists government and private sector projects.

TYPES OF BANKS

Banks can be classified based on **ownership, functions, and scope of operations**.

2.1 Classification by Ownership

1. **Public Sector Banks (PSBs)**
 - Owned by the Government of India (majority stake).
 - Example: State Bank of India (SBI), Punjab National Bank.
 - Focus on social objectives: agriculture, priority sector lending.
2. **Private Sector Banks**

- Majority owned by private shareholders.
- Example: HDFC Bank, ICICI Bank.
- Focus on profitability and modern banking services.

3. Foreign Banks

- Incorporated outside India but operate branches in India.
- Example: HSBC, Citibank.

4. Cooperative Banks

- Owned and managed by members; serve specific communities or regions.
- Focus on agriculture and small-scale industries.
- Example: Mumbai District Cooperative Bank.

5. Regional Rural Banks (RRBs)

- Jointly owned by Government of India, State Government, and sponsor bank.
- Serve rural and semi-urban areas.
- Example: Prathama Bank, Baroda Rajasthan Kshetriya Gramin Bank.

2.2 Classification by Functions

1. **Commercial Banks** – Accept deposits and provide loans; aim at profit and economic development.
2. **Development Banks / Investment Banks** – Provide long-term finance for industrial and infrastructure projects.
 - Example: NABARD, SIDBI, IDBI (initially).
3. **Central Bank** – Regulates currency, credit, and banking operations.
 - Example: Reserve Bank of India.

CHAPTER 3: BANKING SYSTEM IN INDIA

Indian banking system can be broadly classified into:

System	Description
Unit Banking	Single branch bank, localized operations, limited risk spreading.
Branch Banking	Multi-branch network, wider geographic coverage, greater resources.

System	Description
Mixed Banking System	Combination of unit and branch banking.

2.3. Unit Banking

Definition

Unit banking refers to banks **operating from a single office or branch** and performing all banking operations from that location.

Features

- Single branch operation
- Limited geographical reach
- Personalized services
- Limited resources for lending

Advantages

1. Strong customer relationship
2. Simplicity in operations
3. Local decision-making flexibility

Disadvantages

1. Limited deposit mobilization
2. Inability to diversify risk
3. Restricted lending capacity
4. Vulnerable to local economic fluctuations

Examples

- Some rural cooperative banks and urban small banks (historically).

2.4. Branch Banking

Definition

Branch banking refers to banks operating through multiple branches under a single management or corporate structure.

Features

- Centralized management with multiple branches
- Wider geographic coverage
- Diversified risk across regions
- Access to large deposits and lending capacity

Advantages

1. Economies of scale in operations
2. Wider mobilization of funds
3. Ability to lend more and reduce risk
4. Convenience to customers through multiple branches

Disadvantages

1. Higher operational cost
2. Complex management and monitoring
3. Less personalized service in large branches

Examples

- State Bank of India, HDFC Bank, ICICI Bank

2.5. INDIAN COMMERCIAL BANKS

Introduction

Commercial banks are profit-oriented banks that accept deposits and advance loans to individuals, firms, and government entities. They play a crucial role in economic development by mobilizing savings and creating credit.

2.6. Historical Background

1. **Before Independence:** Banking was dominated by private banks like Oudh Commercial Bank, Allahabad Bank, and Imperial Bank of India.
2. **Nationalization:** To ensure financial inclusion and priority sector lending, 14 major banks were nationalized in 1969 and 6 more in 1980.

2.7. Functions of Commercial Banks

Primary Functions:

1. Accepting deposits: savings, current, recurring, fixed deposits
2. Lending funds: loans, cash credit, overdrafts
3. Credit creation: through deposit multiplication

Secondary Functions:

1. Remittance of funds
2. Agency services for government and customers
3. Safe custody of valuables and securities
4. Foreign exchange operations

CHAPTER 5: UNIT II SUMMARY (PART 1)

- Banks are classified by ownership (public, private, foreign, cooperative) and functions (commercial, development, central).
- **Unit banking:** single branch, personalized service, limited reach.

- **Branch banking:** multi-branch, wider coverage, risk diversification.
- **Commercial banks** mobilize savings, provide loans, and facilitate economic growth.
- Nationalization ensured financial inclusion and directed credit to priority sectors.

2.8. NATIONALIZATION OF MAJOR COMMERCIAL BANKS IN INDIA

Introduction

Nationalization refers to the transfer of ownership of banks from private entities to the government. In India, this was done to ensure that banking services reach all sections of society, especially priority sectors like agriculture, small industries, and rural development.

2.9. Historical Background

- **Before Nationalization (Pre-1969):**
 - Indian banking was dominated by private banks serving mainly urban and industrial areas.
 - Rural areas and small borrowers often remained unserved.
- **First Phase – 1969:**
 - 14 major commercial banks were nationalized.
 - Objective: Make credit available to rural, small-scale, and priority sectors.
 - Banks nationalized included: State Bank of India (already government-owned), Punjab National Bank, Bank of Baroda, Canara Bank, etc.
- **Second Phase – 1980:**
 - 6 more banks were nationalized to further improve financial inclusion.
 - Example: Andhra Bank, Corporation Bank.

2.10. Objectives of Nationalization

1. Social Control of Credit – Ensure banks serve national priorities.
2. Financial Inclusion – Provide banking facilities in rural areas and small towns.
3. Priority Sector Lending – Agriculture, small-scale industries, and weaker sections.

4. Prevention of Concentration of Wealth – Avoid dominance of a few industrialists in banking.
5. Promotion of Economic Development – Allocate funds for national development projects.

2.11. Impact of Nationalization

- Increased branch expansion in rural areas.
- Higher lending to priority sectors.
- Strengthened regulatory oversight by RBI.
- Helped stabilize the banking system.
- Enabled banks to act as agents of social and economic change.

2.12. FUNCTIONS OF COMMERCIAL BANKS

Primary Functions of Commercial Banks

A. Accepting Deposits

Banks provide a **safe place for the public to deposit money** and earn interest in some cases.

Types of Deposits:

1. Current Deposit Accounts

- Primarily for **businessmen and traders**.
- Withdrawable at any time.
- Usually **no interest** is paid.
- Example: Merchant deposits with daily transactions.

2. Savings Deposit Accounts

- Encourages **small savers** to deposit money.
- Minimum balance required.
- Banks pay **interest on balances**.
- Example: Student or household savings account.

3. Fixed Deposit Accounts (Term Deposit)

- Money deposited for a **fixed tenure**.

- Higher interest rate than savings accounts.
- Premature withdrawal may attract a penalty.
- Example: 1-year fixed deposit for ₹1 lakh.

4. **Recurring Deposit Accounts**

- Customer deposits **fixed amount every month**.
- Earns interest at **pre-determined rate**.
- Encourages **regular savings habit**.

Importance of Deposits

- Provides **liquidity** for lending.
- Serves as a **source of credit creation**.
- Helps banks manage **working capital requirements**.

B. Lending of Funds

Commercial banks lend money to **meet the credit requirements of various sectors**.

Types of Loans / Advances:

1. **Cash Credit**

- Short-term loan based on stock or inventory.
- Customer can withdraw up to a pre-approved limit.

2. **Overdraft**

- Facility to withdraw more than account balance.
- Used by current account holders.

3. **Loans / Term Loans**

- Fixed amount lent for a specific period.
- Includes short-term, medium-term, and long-term loans.

4. **Bill Discounting**

- Bank discounts bills of exchange (commercial bills) before maturity.
- Provides liquidity to businesses.

5. **Credit against Collateral**

- Loans given against securities, like gold, property, or government bonds.
- Reduces bank's lending risk.

2.13. Secondary Functions of Commercial Banks

1. Agency Functions

- Collects **cheques, bills, dividends** on behalf of customers.
- Makes **payments of rent, insurance, taxes**.

2. Utility Functions

- Provides **safe deposit lockers**.
- Offers **foreign exchange services**.
- Provides **advisory services for investments and business finance**.

3. Social Functions

- Financing **priority sectors**.
- Supporting **government schemes** for agriculture, housing, and MSMEs.

2.14. BANKING MODERNIZATION AND E-BANKING

Introduction

Modern banking relies on technology and electronic services to enhance customer convenience.

2.15. Electronic Banking Services

1. ATM Cards

- Automated Teller Machines for cash withdrawal, deposits, and balance enquiry.

2. Debit Cards

- Directly linked to bank account; used for transactions and purchases.

3. Personal Identification Number (PIN)

- Security code for ATM and debit card transactions.

4. Online Banking

- Access bank accounts via internet or mobile apps.
- Services: fund transfer, bill payment, e-statements.
- 5. **Electronic Fund Transfer (EFT)**
 - Enables inter-bank transfer of funds electronically.
- 6. **Electronic Clearing System (ECS)**
 - Facilitates bulk transactions, such as salaries, dividends, and utility payments.

UNIT II SUMMARY (PART 2)

- Nationalization of banks helped in financial inclusion and priority sector lending.
- Commercial banks perform primary functions (deposits and lending) and secondary functions (agency and social functions).
- Modern banking uses technology and digital channels to improve services and efficiency.
- E-banking and credit creation have become essential for economic growth and financial stability.

UNIT II – PART 3

3.1. E-banking – modern banking services

3.2. Components of E-Banking

3.3. Credit creation by banks

3.4. Mechanism of Credit Creation

3.5. Factors Affecting Credit Creation

3.6. Activities and case studies

3.7. E-Banking and Credit Creation by Banks

3.1. E-BANKING – MODERN BANKING SERVICES

Introduction

With technological advancement, banking has moved from manual branch operations to electronic banking, providing convenience, speed, and efficiency to customers. E-banking allows customers to perform banking transactions without visiting a branch physically.

3.2. Components of E-Banking

A. Automated Teller Machines (ATM)

- Definition: Electronic machines that allow customers to withdraw cash, deposit money, and check balances anytime.
- **Features:**
 1. 24/7 availability
 2. Multi-currency dispensing
 3. Mini-statements for recent transactions
- **Advantages:**

- Reduces need for branch visits
- Instant access to funds
- Enhances customer satisfaction
- **Disadvantages:**
 - Limited to network coverage
 - Security risks like card skimming
- **Example:** SBI, HDFC ATMs across India

B. Debit Cards

- **Definition:** Bank-issued card linked directly to a savings or current account, allowing immediate fund transfer during purchases or cash withdrawals.
- **Features:**
 1. PIN-protected
 2. Online and offline transaction capability
 3. International usage for some cards
- **Advantages:**
 - Reduces dependency on cash
 - Quick and convenient
- **Disadvantages:**
 - Risk of misuse if PIN is compromised

C. Personal Identification Number (PIN)

- **Definition:** A secret numeric code used to authenticate ATM or debit card transactions.
- **Importance:**
 1. Prevents unauthorized access
 2. Ensures safe electronic transactions

D. Online Banking

- **Definition:** Banking services accessible via internet or mobile applications.
- **Services:**

- Fund transfer (NEFT, RTGS, IMPS)
- Online bill payments
- E-statements and account monitoring
- **Advantages:**
 - Convenience of 24/7 banking
 - No geographic limitation
 - Easy record-keeping
- **Disadvantages:**
 - Risk of cyber fraud
 - Dependence on internet connectivity

E. Electronic Fund Transfer (EFT)

- **Definition:** System for transferring funds electronically from one bank to another.
- **Types:**
 1. NEFT (National Electronic Funds Transfer): Batch processing system; operates on hourly settlements.
 2. RTGS (Real-Time Gross Settlement): Large-value transactions settled in real-time.
 3. IMPS (Immediate Payment Service): Instant fund transfer 24/7 via mobile or internet banking.
- **Advantages:**
 - Faster and secure transactions
 - Reduces paperwork
- **Disadvantages:**
 - Transaction fees may apply

F. Electronic Clearing System (ECS)

- **Definition:** A centralized system for bulk electronic credit or debit transactions, e.g., salary payments, dividend payments, utility bills.
- **Types:**
 1. ECS Credit: Employer pays salary directly to employees' accounts.

2. ECS Debit: Utility bills automatically debited from customer accounts.
- **Advantages:**
 - Efficient and paperless
 - Reduces errors in bulk payments
 - **Disadvantages:**
 - Requires correct account information
 - Dependent on bank processing schedules

3.3. CREDIT CREATION BY BANKS

Introduction

One of the most important functions of banks is credit creation, which fuels economic growth. Banks can lend more money than they physically hold in deposits, using the fractional reserve system.

3.4. Mechanism of Credit Creation

1. **Deposits:** Customer deposits money in the bank.
2. **Reserves:** Bank keeps a portion as Cash Reserve Ratio (CRR) with RBI.
3. **Lending:** Remaining funds are lent to borrowers.
4. **Re-deposit:** Borrowers deposit funds into banks, repeating the cycle.

Importance:

- Supports investment and consumption.
- Expands money supply in the economy.
- Encourages economic development.

3.5. Factors Affecting Credit Creation

1. Cash Reserve Ratio (CRR)
2. Liquidity of Banks
3. Public's Preference for Cash vs. Deposits
4. RBI's Monetary Policy
5. Demand for Credit

3.6. ACTIVITIES AND CASE STUDIES

Activity 1: Simulate E-Banking Transactions

- Create a mock ATM, debit card, and online banking transaction scenario.
- Student's record deposit, withdrawal, and fund transfer processes.

Activity 2: Credit Creation Exercise

- Assume a bank has ₹5, 00,000 deposits and $CRR = 10\%$.
- Calculate total potential credit created through the banking system.

Case Study 1: Digital Banking Impact

- Analyze how UPI and NEFT have changed payment systems in India.
- Highlight benefits and potential cybersecurity risks.

Case Study 2: RBI CRR Change

- RBI increases CRR from 4% to 5%.
- Discuss its impact on credit creation, lending capacity, and money supply.

QUESTION BANK

A. Objective Questions (MCQs)

1. ATM stands for:
 - a) Automated Teller Machine
 - b) Automatic Transaction Machine
 - c) Account Transfer Mechanism
 - d) None of the above
2. ECS is mainly used for:
 - a) Individual cash withdrawals
 - b) Bulk credit/debit transactions
 - c) Loan sanction
 - d) None of the above
3. Maximum credit created by a bank depends on:
 - a) CRR
 - b) Bank Rate
 - c) Repo Rate
 - d) None of the above

B. Short Answer Questions

1. Explain the types of deposits accepted by commercial banks.
2. What are the advantages of E-banking?
3. Define credit creation and explain its mechanism.
4. Distinguish between NEFT and RTGS.

C. Long Answer Questions

1. Discuss the role of ATMs, debit cards, PINs, and online banking in modern banking.
2. Explain Electronic Fund Transfer (EFT) and Electronic Clearing System (ECS) with examples.
3. Elaborate on the process of credit creation by commercial banks.
4. Describe the factors affecting the credit creation potential of banks.

SUMMARY

- E-banking has revolutionized banking operations, providing convenience, speed, and security.
- Tools like ATM, debit card, PIN, online banking, EFT, ECS make transactions efficient and paperless.
- Credit creation allows banks to expand money supply and finance economic activities.
- UNIT II highlights the evolution, operations, and modern technological aspects of commercial banks.

UNIT IV

4.1. Introduction to bank accounts

4.2. Importance of Bank Accounts

4.3. Opening of a bank account

4.4. KYC (know your customer) requirements

4.5. Types of deposit accounts

4.6. Types of customers

4.7. Importance of customer relations

4.8. Principles of Good Customer Relations

4.9. Benefits

4.10. Customer grievances and redressal measures

4.11. Principles of lending, types of borrowings, precautions by bankers

4.12. Principles of sound lending

4.13. Types of borrowings / bank advances

4.15. Security and collateral in lending

4.16. Precautions to be taken by a banker

4.17. Types of loan customers

4.18. Activities and case studies

4.1. INTRODUCTION TO BANK ACCOUNTS

A **bank account** is a formal arrangement between a bank and a customer, allowing the customer to **deposit and withdraw money** and avail of other banking services.

4.2. Importance of Bank Accounts

1. Safe custody of money – Protects savings from theft or loss.
2. Convenient transactions – Allows withdrawals, payments, and fund transfers.
3. Financial record-keeping – Helps track income and expenses.
4. Credit history creation – Necessary for loans and credit facilities.
5. Access to modern banking services – Internet banking, ATM, ECS, etc.

4.3. OPENING OF A BANK ACCOUNT

Procedure for Opening an Account

1. Select Account Type – Savings, Current, Recurring, Fixed Deposit.
2. Complete Account Opening Form – Provides personal details like name, address, contact, occupation, and nominee.
3. Submit KYC Documents – “Know Your Customer” guidelines (Proof of identity, proof of address, photographs).
4. Initial Deposit – Minimum amount required varies with account type.
5. Bank Verification – Bank verifies documents and approves account.
6. Issue Passbook / Cheque Book / Debit Card – Enables transactions and account management.

4.4. KYC (Know Your Customer) Requirements

Banks must verify customers to prevent fraud, money laundering, and terrorism financing.

Document Type	Examples
Proof of Identity	Aadhaar, PAN Card, Passport, Voter ID

Document Type	Examples
Proof of Address	Utility bills, Rent agreement, Passport, Aadhaar
Photographs	Recent passport-size photos

Importance of KYC

- Ensures legal compliance
- Protects the bank and customer
- Builds trust and transparency

4.5. TYPES OF DEPOSIT ACCOUNTS

Savings Account

- Purpose: Encourages personal savings
- Features: Interest-bearing, limited withdrawals per month, passbook or statement provided
- Example: SBI Savings Account

Current Account

- Purpose: For businessmen, traders, and firms
- Features: No interest, overdraft facility, unlimited transactions
- Example: HDFC Current Account

Fixed Deposit Account

- Purpose: Invest for a fixed period at higher interest
- Features: Premature withdrawal may attract penalty, interest compounded quarterly or annually
- Example: ICICI 1-year FDR

Recurring Deposit Account

- Purpose: Save a fixed amount monthly
- Features: Fixed tenure, earns interest at pre-determined rate, encourages disciplined savings
- Example: SBI Recurring Deposit

4.6. TYPES OF CUSTOMERS

Banks serve a wide variety of customers:

Individuals

- Salaried persons, professionals, students, retirees
- Use savings, recurring, or fixed deposit accounts

Firms

- Partnership or sole proprietorship businesses
- Use current accounts for daily operations

Trusts

- Religious, charitable, or educational organizations
- Special accounts maintained for donations and charitable activities

Companies

- Public or private limited companies
- Require current accounts for business transactions, payroll, and trade finance

4.7. IMPORTANCE OF CUSTOMER RELATIONS

Definition

Customer relations refer to the relationship between the bank and its customers, aiming for trust, satisfaction, and loyalty.

4.8. Principles of Good Customer Relations

1. **Transparency** – Clear communication about services, charges, and policies
2. **Responsiveness** – Quick resolution of queries and complaints
3. **Courtesy** – Respectful and helpful staff
4. **Personalization** – Understanding individual needs
5. **Accessibility** – Easy access to banking services

4.9. Benefits

- Customer loyalty and retention
- Increased deposits and business
- Positive word-of-mouth promotion

4.10. CUSTOMER GRIEVANCES AND REDRESSAL MEASURES

Common Customer Complaints

1. Delayed cheque clearance
2. Unauthorized transactions
3. Non-receipt of passbook or statements
4. ATM / debit card issues
5. Internet banking failures

Grievance Redressal Mechanism

1. **Internal Bank Mechanism**
 - Complaint registered at branch level or customer care
 - Bank provides response within a specified time (usually 30 days)
2. **Banking Ombudsman Scheme**
 - Introduced by **RBI** to resolve complaints against banks
 - Free and accessible for all customers
 - Can cover issues like:
 - Delays in banking services

- Refusal of loans
- ATM/debit card problems
- Ombudsman decision is **binding** on banks; customers may appeal to courts if unsatisfied

ACTIVITIES AND CASE STUDIES

Activity 1: Account Opening Simulation

- Students prepare a mock account opening form for:
 - Savings account
 - Current account
 - Fixed deposit

Activity 2: Customer Complaint Handling

- Role-play scenario where a customer complains about ATM failure or wrong debit
- Students resolve issue using grievance redressal steps

Case Study 1: Banking Ombudsman

- Analyze a real-life ombudsman case and summarize:
 - Complaint
 - Bank response
 - Ombudsman decision

CHAPTER 8: QUESTION BANK – UNIT III

A. Objective Questions (MCQs)

1. KYC stands for:
 - a) Know Your Customer
 - b) Keep Your Cash

- c) Know Your Credit
 - d) None of the above
2. Savings account interest is:
- a) Fixed 0%
 - b) Provided by the bank
 - c) Not allowed
 - d) Only for companies
3. Banking Ombudsman is appointed by:
- a) Government of India
 - b) RBI
 - c) Commercial Banks
 - d) Supreme Court

B. Short Answer Questions

1. Explain the procedure for opening a bank account.
2. Differentiate between savings and current accounts.
3. Discuss the types of customers in banks.
4. What are the main principles of good customer relations?

C. Long Answer Questions

1. Describe the KYC requirements for account opening and their importance.
2. Explain the Banking Ombudsman Scheme and its role in grievance redressal.
3. Discuss the importance of customer relations in modern banking.
4. Elaborate on the types of deposit accounts and their features.

4.11. PRINCIPLES OF LENDING, TYPES OF BORROWINGS, PRECAUTIONS BY BANKERS

INTRODUCTION TO BANK LENDING

Lending is the primary function of commercial banks. Banks provide loans and advances to individuals, businesses, and government institutions to facilitate economic activity.

Importance of Lending

1. Generates interest income for banks.
2. Supports industrial, agricultural, and commercial activities.
3. Promotes economic development and employment.
4. Strengthens customer relationships through financial support.

Definition of Lending

According to the Indian Banking Regulation Act, 1949:

Lending is the provision of money, goods, or services by a bank to a borrower under mutually agreed terms.

4.12. PRINCIPLES OF SOUND LENDING

A banker must follow certain principles to minimize risk and ensure repayment.

The 5 C's of Credit

1. **Character**
 - Borrower's honesty and integrity.
 - Past repayment behavior.
 - Credit history assessment.
2. **Capacity**
 - Borrower's ability to repay.
 - Evaluated through income, business turnover, and cash flows.

3. **Capital**

- Borrower's own investment in the business/project.
- Ensures commitment and reduces dependency on borrowed funds.

4. **Collateral / Security**

- Tangible assets pledged (property, machinery, stocks).
- Provides bank protection in case of default.

5. **Conditions**

- Purpose of the loan.
- Economic environment and industry trends.
- Terms and interest rates.

Additional Lending Principles

1. **Safety** – Loans must be recoverable.
2. **Liquidity** – Bank should not overextend; maintain cash for withdrawals.
3. **Profitability** – Interest income should justify risk.
4. **Purpose** – Loans must serve productive or genuine purposes.
5. **Diversification** – Avoid concentration of loans to a single sector or borrower.

4.13. TYPES OF BORROWINGS / BANK ADVANCES

Banks offer various **loan facilities** based on purpose, term, and security.

Short-Term Borrowings

- **Tenure:** Up to 1 year
- **Purpose:** Working capital, trade finance, seasonal needs
- **Examples:** Cash credit, overdraft, trade bills discounting

Medium-Term Borrowings

- **Tenure:** 1 to 5 years
- **Purpose:** Purchase of machinery, expansion of business
- **Examples:** Term loans, hire purchase loans

Long-Term Borrowings

- **Tenure:** Over 5 years
- **Purpose:** Industrial projects, infrastructure development
- **Examples:** Project finance, mortgage loans

Specialized Borrowings

Type of Borrowing	Purpose	Security
Cash Credit	Working capital	Stock / inventory
Overdraft	Temporary cash shortage	Current account balance
Bill Discounting	Trade bills	Invoice / promissory note
Term Loan	Business expansion	Machinery, land, property
Loan Against Securities	Investment funding	Shares, bonds, government securities

4.15. SECURITY AND COLLATERAL IN LENDING

Definition of Collateral

Collateral is an **asset pledged by the borrower** to secure repayment of a loan.

Common Forms of Security

1. **Movable Assets:** Machinery, vehicles, stocks
2. **Immovable Assets:** Land, buildings, property
3. **Financial Securities:** Fixed deposits, government bonds, shares
4. **Guarantees:** Personal or corporate guarantees from third parties

Importance

- Reduces bank's risk of loss
- Encourages borrower discipline
- Provides legal recourse in case of default

4.16. PRECAUTIONS TO BE TAKEN BY A BANKER

Before granting a loan, a banker must evaluate the borrower, purpose, and security.

Assessment of Borrower

- Check character, credit history, income, and business stability
- Verify identity and KYC documents

Assessment of Purpose

- Loan must be for productive or legal purposes
- Avoid financing speculative or illegal activities

Assessment of Security

- Value of collateral should cover loan amount
- Legal verification of property and title deeds
- Ensure collateral is easily liquidated if required

Documentation

- Loan agreement with clear terms
- Promissory note / guarantee / mortgage deed
- Terms of repayment, interest rate, and penalties

Monitoring and Follow-Up

- Regular inspection of borrower's business or project
- Timely collection of interest and principal
- Early warning for potential defaults

4.17. TYPES OF LOAN CUSTOMERS

1. **Individuals** – Salaried or self-employed for personal or business purposes

2. **Firms** – Partnership firms for working capital and expansion
3. **Companies / Corporates** – Large loans for infrastructure or capital expenditure
4. **Government / Semi-Government Institutions** – Special loans under schemes

4.18. ACTIVITIES AND CASE STUDIES

Activity 1: Loan Appraisal Exercise

- Analyze a **mock loan application** of a small business
- Evaluate borrower's **character, capacity, collateral, and purpose**

Activity 2: Risk Assessment Simulation

- Divide students into groups
- Identify **risks in granting loans** to different types of borrowers

Case Study 1: Non-Performing Assets (NPA)

- Examine why a loan became NPA
- Discuss measures that could have prevented default

Case Study 2: Bank Lending to MSMEs

- Analyze bank's lending policies for Micro, Small & Medium Enterprises
- Highlight safeguards and precautions

CHAPTER 8: QUESTION BANK – UNIT IV

A. Objective Questions (MCQs)

1. The “C” in 5 C’s of Credit stands for:
 - a) Cash
 - b) Collateral

- c) Character
- d) Capital
- 2. Short-term loans are usually given for:
 - a) Industrial expansion
 - b) Working capital requirements
 - c) Infrastructure projects
 - d) Housing
- 3. Collateral helps banks to:
 - a) Increase profit
 - b) Reduce risk of loan default
 - c) Attract customers
 - d) None of the above

B. Short Answer Questions

1. Explain the 5 C's of credit in lending.
2. Distinguish between short-term, medium-term, and long-term loans.
3. What precautions should a banker take before granting a loan?
4. Discuss the importance of collateral in lending.

C. Long Answer Questions

1. Describe the principles of sound lending and their practical application.
2. Explain the types of borrowings provided by commercial banks with examples.
3. Discuss the steps and precautions taken by a banker in loan appraisal and disbursement.
4. Elaborate on the role of security and collateral in ensuring safe lending practices.

UNIT IV – SUMMARY

- Lending is a core function of banks and contributes to economic development.
- Sound lending principles (5 C's, safety, liquidity, profitability) reduce risk.
- Loans can be short-term, medium-term, or long-term, depending on purpose.
- Precautions, collateral, documentation, and monitoring are essential for safe lending.

- UNIT IV emphasizes risk management and responsible banking practices.

UNIT V – NEGOTIABLE INSTRUMENTS

5.1. Introduction to negotiable instruments

5.2. Characteristics of Negotiable Instruments

5.3 Importance of Negotiable Instruments

5.4. Types of negotiable instruments

5.5. Promissory note

5.6. Bill of exchange

5.7. Difference between PN and BOE

5.8. Types of Bills of Exchange

5.9. Cheques

5.1. INTRODUCTION TO NEGOTIABLE INSTRUMENTS

Definition

A negotiable instrument is a written document guaranteeing the payment of a specified sum of money either on demand or at a future date, which is transferable by endorsement or delivery.

Legal Reference: Negotiable Instruments Act, 1881 (India)

5.2. Characteristics of Negotiable Instruments

1. Written and signed
2. Unconditional promise or order to pay
3. Certain sum of money specified
4. Payable on demand or at a fixed time
5. Transferable by endorsement or delivery
6. Holder in due course can claim payment

5.3 Importance of Negotiable Instruments

- **Facilitate trade and commerce**
- **Reduce the need to carry cash**
- **Provide legal security for transactions**
- **Enable easy credit creation**

5.4. TYPES OF NEGOTIABLE INSTRUMENTS

The main negotiable instruments include:

1. Promissory Note (PN)
2. Bills of Exchange (BoE)
3. Cheque
4. Draft

5.5. PROMISSORY NOTE

Definition

A promissory note is a written promise by one person (maker) to pay a fixed sum to another person (payee) on demand or at a future date.

Legal Reference: Section 4, Negotiable Instruments Act, 1881

Features

1. Written and signed by the maker
2. Contains unconditional promise to pay money
3. Amount must be certain
4. Payable to order or bearer
5. Payable on demand or at a fixed future date

Advantages

- Simple and convenient for credit transactions
- Legally enforceable
- Can be **transferred**

Example

A promises to pay B ₹50,000 on 31st December 2025.

5.6.BILL OF EXCHANGE

Definition

A bill of exchange is an order in writing by one person (drawer) to another (drawee) to pay a fixed sum to a third person (payee) at a future date.

Legal Reference: Section 5, Negotiable Instruments Act, 1881

Features

1. **Written and signed** by the drawer
2. **Unconditional order to pay money**
3. Specifies **sum, drawee, and payee**
4. Payable **on demand or at a fixed future date**
5. Transferable by **endorsement or delivery**

5.7. Difference between PN and BoE

Feature	Promissory Note	Bill of Exchange
Nature	Promise to pay	Order to pay
Parties	Maker & Payee	Drawer, Drawee, Payee
Liability	Maker	Drawee (acceptor)

Feature	Promissory Note	Bill of Exchange
Transfer	Endorsement/delivery	Endorsement/delivery

5.8. Types of Bills of Exchange

1. Sight Bill – Payable on demand
2. Usance Bill / Term Bill – Payable after a specific period
3. Clean Bill – No documents attached
4. Documentary Bill – Accompanied by documents (e.g., goods receipt)

5.9. CHEQUES

Definition

A cheque is a bill of exchange drawn on a bank, payable on demand. Legal Reference: Section 6, Negotiable Instruments Act, 1881

Features

1. Written and signed by the drawer
2. Drawn on a bank
3. Payable on demand
4. Payable to order or bearer
5. Can be crossed for safety

Crossing of Cheques

1. General Crossing – Two parallel lines; payable only through a bank
2. Special Crossing – Named bank specified; safer for payment
3. Account Payee Crossing – Amount credited to payee's account only

5.4 Endorsement

- Signing the cheque by payee to transfer rights
- Types: Blank, Full, Restrictive, Conditional

Material Alteration

- Any unauthorized change in cheque (amount, date, payee)
- Makes cheque invalid unless consented by drawer

Paying Banker

- Bank on which the cheque is drawn
- Duties: Pay on presentment, verify signature, ensure sufficient funds
- Rights: Refuse payment if insufficient funds or irregularity

Collecting Banker

- Bank receiving the cheque for collection
- Duties: Present to drawee bank, remit funds
- Rights: Charge commission, receive reimbursement

5.8 Dishonour of Cheques

Occurs due to:

1. Insufficient funds
2. Signature mismatch
3. Account closed
4. Material alteration

Legal Action: Dishonored cheque may lead to prosecution under **Section 138, NI Act**

5.10.BANK DRAFTS / PAY ORDER

Definition

A draft / pay order is a written order issued by a bank to pay a specified sum to a person at a specified bank branch.

Features

1. Issued and signed by the bank
2. Guaranteed payment
3. Used for safe transfer of funds
4. Payable on demand

Advantages

- Safe mode of transferring funds
- Can be issued across cities and branches
- Reduces risk of dishonour

ACTIVITIES AND CASE STUDIES

Activity 1: Cheque Handling Simulation

- Students issue a mock cheque, cross it, endorse it, and simulate payment through banks.

Activity 2: Bill of Exchange Practice

- Prepare a usance bill for trade transaction, showing drawer, drawee, payee, and maturity date.

Case Study 1: Dishonoured Cheque

- Analyze a real-life scenario under Section 138 NI Act and discuss remedies.

Case Study 2: Use of Bank Draft

- How a bank draft ensures safe intercity payment and reduces risk of fraud.

CHAPTER 8: QUESTION BANK – UNIT V

A. Objective Questions (MCQs)

1. A cheque is drawn on:
 - a) Drawer
 - b) Payee
 - c) Bank
 - d) Government
2. A promissory note involves how many parties?
 - a) One
 - b) Two
 - c) Three
 - d) Four
3. Crossing a cheque ensures:
 - a) Cash payment
 - b) Safer transfer
 - c) Dishonour
 - d) No legal effect

B. Short Answer Questions

1. Define negotiable instruments and explain their importance.
2. Distinguish between promissory note and bill of exchange.
3. Explain the duties of paying and collecting bankers.
4. What is cheque crossing and why is it done?

C. Long Answer Questions

1. Discuss the types, features, and advantages of negotiable instruments.

2. Explain the roles, rights, and duties of paying and collecting bankers.
3. Describe the process and types of endorsement of cheques.
4. Explain dishonour of cheques and legal remedies under Section 138 of the Negotiable Instruments Act.

CHAPTER 9: UNIT V – SUMMARY

- Negotiable instruments facilitate trade and credit transactions safely.
- Key instruments: Promissory Note, Bill of Exchange, Cheque, Draft
- Cheques can be crossed, endorsed, and presented through banks.
- Paying and collecting bankers have specific duties and rights.
- Dishonour of cheques attracts legal action under Section 138 NI Act.
- UNIT V emphasizes legal, procedural, and practical aspects of banking transactions.