BANKING PRACTICES

(UNIT-1)

BANKING

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BANKING

MEANING OF BANKING:

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.

A banking company is a company, which accepts deposits of money for the purpose of lending or investment from the public which is payable on demand (Savings Bank and Current Accounts) or otherwise (after a period like Fixed Deposits) and withdrawable by cheque (Savings Bank and Current Accounts) or otherwise (by other instruments like fixed deposits).

DEFINATION OF BANKING:

Bank is an institution that deals in money. Banks accept deposits and make loans and derive a profit from the difference in the interest rates paid and charged, respectively moreover it provides other financial services.

FUNCTION OF BANKING

Banks' functions can be segregated into Primary and Secondary functions as follows:

Functions of Bank

Primary Functions		Secondary Functions	
Accepting Deposits	**Granting Advances**	**Agecy Functions**	**Utility Fuctions**
l Saving Deposits	l Overdraft	l Banking of Funds	l Drafts
l Fixed Deposits	l Cash Credit	l Periodic Payments	l Lockers
l Current Deposits	l Loans	l Collection Management	l Underwriting
l Recurring Deposits	l Discounting of Bills	l Periodic Collections	l Social Welfare Programmes
		l Other Agency Functions	l Other Utility Functions

A. **Primary Functions:** There are two primary functions of a commercial bank as given in Banking Regulations Act, 1949.

- ❖ **Accepting deposits**: The money from the public in the form of
  - ➢ Savings accounts
  - ➢ Current accounts
  - ➢ Fixed deposits
  - ➢ Recurring deposits

  These deposits are withdrawable by cheque. order or otherwise

- ❖ **Advancing Loans:** The other important function of the banks is to make loans and advances to the needy people in the form of:
  - ➢ Over drafts
  - ➢ Cash credits
  - ➢ Term loans
  - ➢ Discounting of bills
  - ➢ Credit Cards loan

Banks are also permitted to invest their funds in securities which may be Government securities or corporate securities.

B. **The secondary Functions of a Banks**

- ❖ **Transfer of funds:** Helps customers to transfer money to another customer or the same bank or of any other bank in the same country or even in another foreign country.

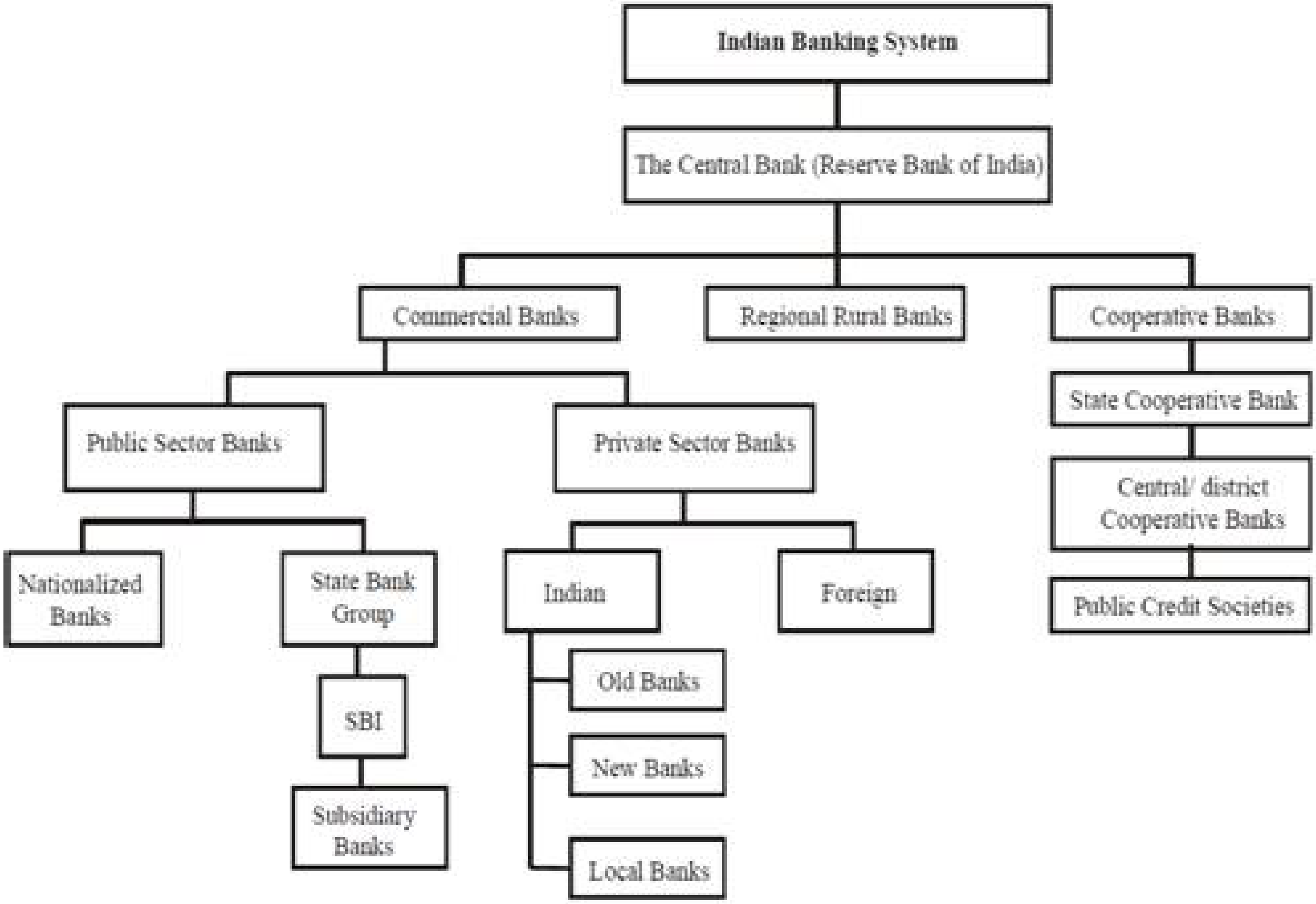
Agency service provided by Commercial Banks:

- ➢ Purchasing and selling of shares, securities, bonds etc. on behalf of its customers
- ➢ Collection and regular payments of bills, checks and other commercial instruments, dividends, interest etc. as per the standing instructions given by their customers.
- ➢ Collection and payment of rents, insurance premium and other charges.
- ➢ Acts as trustees, representatives and executors of their clients.
- ➢ Acts as income tax consultants and they prepare and finalize the income tax returns of their clients.

- ❖ **General Utility services rendered by Commercial Banks:**

- ➢ Safety vaults or lockers to provide security to their valuables like ornaments, documents etc.
- ➢ Encash/Issue of traveler's checks from/to tourists.

CLASSIFICATION OF BANKS



Reserve Bank of India (RBI), is the Central Bank of the country. RBI does not undertake the conventional banking business of accepting deposits from the public and lending to the public.

A. Commercial Banks:

Commercial bank is an institution that accepts deposit, makes loans and offer related services. These institutions run to make profit. They cater to the financial requirements of industries and various sectors like agriculture, rural development, etc. it is a profit-making institution owned by government or private of both.

Commercial banks include public sector, private sector, foreign banks and regional rural banks:

- **Public Sector Banks:**

Public Sector Banks (PSBs) are banks where in the majority stake (i.e. more than 50%) is held by Government of India e.g. State Bank of India, Punjab National Bank, Bank of Baroda etc.

The shares of these banks are listed on stock exchanges. There are a total of 27 PSBs in India [21 Nationalised banks + 6 State Bank group (SBI + 5 associates)].

The objectives behind nationalisation were:

- To break the ownership and control of banks by a few business families,
- To prevent the concentration of wealth and economic power,
- To mobilize savings from masses from all parts of the country,
- To cater to the needs of the priority sectors.....

- **Private Sector Banks:**

New Private Sector Banks: HDFC Bank, ICICI Bank, Axis Bank, etc. opened after 1991 due to opening up of the economy by the Government of India. Private sector banks are those whose equity is held by private shareholders. Private sector bank plays a major role in the development of Indian banking industry. Old Private Sector Banks: are like J & K Bank, Development Credit Bank, Karnataka Bank, South India Bank etc., which were all opened prior to 1991.

a. Foreign Banks:

Foreign Banks (43): Citibank, Bank of America etc., which are incorporated abroad but having branches in India. All types of banking transactions are undertaken.

b. Regional Rural Banks:

These are state sponsored regional rural oriented banks. They provide credit for agricultural and rural development. The main objective of RRB is to develop rural economy. Their borrowers include small and marginal farmers, agricultural labourers, artisans etc. NABARD holds the apex position in the field of agricultural and rural finance. RRBs are jointly owned by the Government of India (50%), one of the Public Sector Banks (35%) and the Government of the State in which the RRB is situated (15%) – meant to serve rural areas. All the banking services required by customers in the rural areas are available.

B. Co-operative Banks:

Cooperative banks are so-called because they are organised under the provisions of the Cooperative Credit Societies Act of the states. The major beneficiary of the Cooperative Banking is the agricultural sector in particular and the rural sector in general. The cooperative banks in India play an important role even today in rural financing. The enactment of Co-operative Credit Societies Act, 1904, however, gave the real impetus to the movement. The Cooperative Credit Societies Act, 1904 was amended in 1912, with a view to broad basing it to enable organisation of non-credit societies. They are organised and managed on the principal of co-operation and mutual help. The main objective of co-operative bank is to provide rural credit.

Three tier structures exist in the cooperative banking:

- ➢ State cooperative bank at the apex level.
- ➢ Central cooperative banks at the district level.
- ➢ Primary cooperative banks and the base or local

➢ **Payment Banks:**

On 19August, 2015, the Reserve Bank of India gave "in-principle" licences to eleven entities to launch payments banks:

- Aditya Birla Nuvo
- Airtel M Commerce Services
- Cholamandalam Distribution Services
- Department of Posts
- FINO Pay Tech
- National Securities Depository
- Reliance Industries
- Dilip Shanghvi, Sun Pharmaceuticals
- Vijay Shekhar Sharma, Paytm
- Tech Mahindra
- Vodafone M-Pesa

The "in-principle" license is valid for 18 months within which the entities must fulfil the requirements. They are not allowed to engage in banking activities within the period. The RBI will consider grant full licenses under Section 22 of the Banking Regulation Act, 1949, after it is satisfied that the conditions have been fulfilled.

➢ **Small Finance Banks:**

Small finance banks are a type of niche banks in India. Banks with a small finance bank license can provide basic banking service of acceptance of deposits and lending. The aim behind these to provide financial inclusion sections of the economy not being served by other banks, such as small business units, small and marginal farmers, micro and small industries and un organised sector entities.

Names of selected applicants

- Equitas Holdings Private Limited, Chennai
- ESAF Microfinance and Investments Private Ltd., Chennai
- Janalakshmi Financial Services Private Limited, Bengaluru
- RGVN (North East) Microfinance Limited, Guwahati
- Suryoday Micro Finance Private Ltd., Navi Mumbai
- Ujjivan Financial Services Private Ltd., Bengaluru
- Utkarsh Micro Finance Private Ltd., Varanasi

The "in-principle" approval granted will be valid for 18 months to enable the applicants to comply with the requirements under the Guidelines and fulfil other conditions as may be stipulated by the RBI. On being satisfied that the applicants have complied with the requisite conditions laid down by it as part of "in-principle" approval, the RBI would consider granting them a licence for commencement of banking business under Section 22(1) of the Banking Regulation Act, 1949. Until a regular licence is issued, the applicants cannot undertake any banking business.

Reserve Bank of India

RBI is the Central Bank of our country. It was established on April 1, 1935 under the RBI Act, 1934. In India, the RBI supervises operations of all the banks.

RBI Structure:

The Central Board of Directors comprises of the Governor, 4 Deputy Governors and 15 Directors nominated bythe Union Government. Its headquarter is in Mumbai. RBI has 27 regional offices. It has setup five training establishments e.g. College ofAgricultural Banking and Reserve Bank of India Staff College– Pune, National Institute for Bank Management- Pune, Indira Gandhi Institute for Development and Research – Mumbai, Institute for Development and Research in Banking Technology (IDRBT) - Hyderabad.

Its subsidiaries are Deposit Insurance and Credit Guarantee Corporation of India (DICGC) and Bharatiya Reserve Bank Note Mudran Private Limited (BRBNMPL).

RBI Preamble: The Preamble of the Reserve Bank of India Act, 1934 describes the basic objectives of the Reserve Bank of India as:

"To regulate the issue of Bank Notes and keeping of reserves with a view to securing monetary stability in India and generally to operate the currency and credit system of the country to its advantage."

Departments for different functions

- RBI's internal management is based on functional specialisation and coordination amongst about 20 departments.
- Departments oversee specific functions such as Currency Management, Banking Supervision, financial markets, risk monitoring etc.

Functions of RBI

Monetary

The RBI monetary is mainly maintain financial stability and the required level of liquidity in the economy.

Authority:

- Formulates, implements and monitors the monetary policy.
- Objective: maintaining price stability and ensuring adequate flow of credit to productive

sectors. There are various instruments for monetary control:

- Cash Reserve Ratio (CRR): indicates the quantum of cash that banks are required to keep with the Reserve Bank of India.
- Statutory Liquidity Ratio (SLR): prescribesthe amount of money that banks must invest in securities issued by the Government.
- Liquidity Adjustment Facility (LAF): is to manage the day-to-day liquidity in the banking system. Under this facility RBI announces Repo Rate (Repurchase Rate) which is the rate at which RBI lends short term money to banks. Reverse Repo Rate is the rate at which banks park their short-term excess liquidity with the RBI.

Regulator and supervisor of the financial system:

- Prescribes broad parameters of banking operations within which the country's banking and financial system functions.
- Objective: maintain public confidence in the system, protect depositors' interest and provide cost- effective banking services to the public.

Manager of Foreign Exchange:

- Administers the Foreign Exchange Management Act, 1999.
- Objective: to facilitate external trade and payment and promote orderly development and maintenance of foreign exchange market in India.

Issuer of Currency:

- Issues and exchanges or destroys currency and coins not fit for circulation.
- Objective: to give the public adequate quantity of supplies of currency notes and coins and in good quality.

Developmental role:

- Performs a wide range of promotional functions to support national objectives.

Related Functions:

- Banker to the Government: performs merchant banking function for the central and the state governments; also acts as their banker.
- Banker to banks: maintains banking accounts of all scheduled banks.

Payment & Settlement Systems:

Theregulationandsupervisionofpaymentsystemsisbeingincreasinglyrecognisedasacorerespo nsibility of central banks. As per the Payment and Settlement Systems Act, 2007 only payment systems authorised by the Reserve Bank can be operated in the country. The Reserve Bank, as the regulator of financial systems, has been initiating reforms in the payment and settlement systems to ensure efficient and faster flow of funds among various constituents of the financial sector.

Following are the initiatives undertaken by Reserve bank for this function:

- **Computerization:** Aims at reducing the time taken in clearing, balancing and settlement, apart from providing accuracy in the final settlement.
- **Mechanization:** of the clearing operations by introducing the MICR (Magnetic Ink Character Recognition) code.
- **High Value Clearing (HVC):** introduced by the Reserve Bank was aimed at faster clearing of large value cheques from selected branches of banks for same day settlement.
- **Cheque Truncation System (CTS):** eliminates the physical movement of cheques and provides a more secure and efficient method for clearing cheques.
- **Electronic Clearing Service (ECS):** uses a series of electronic payment instructions for transfer of funds instead of paper instruments.
- **National Electronic Clearing Service (NECS):** facilitates credits to bank accounts of multiple customers against a single debit of remitter's account.
- **Electronic Funds Transfer:** enable an account holder of a bank to electronically transfer funds to another account holder with any other participating bank.
- **The Real Time Gross Settlement (RTGS):**

  system settles all inter-bank payments and customer transactions above rupees two lakhs.
- **Pre-paid payment instruments:** facilitate purchase of goods and services against the value stored onthese instruments.

- **Mobile Banking:** are being used as a medium for providing banking services.
- Reserve Bank of India (RBI), Central Bank of the Country. RBI does not undertake the conventional banking business of accepting deposits from the public and lending to the public
- National Agricultural Bank for Rural Development **(NABARD).** (This is the Apex Bank for all Agricultural financing by all other banks in the country-guidance, to the banks, refinancing their agricultural advances etc.). NABARD borrows from public by floating bonds for the purpose of financing other banks for agricultural lending.

- **EXIM Bank (Export-Import Bank of India):**

This is the apex bank in India in the field of finance for Exports and Imports, to encourage and assist exporters of Indian products. EXIM Bank borrows from public by floating bonds and also accepts Fixed Deposits for the purpose of refinancing other banks and also directly to exporters.