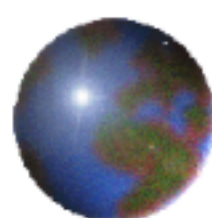


PRINCIPLES AND PRACTICES OF BANK





MODULE 1

BANKING SYSTEM AND STRUCTURE IN AND COMMERCIAL BANKING



Outline

Banking system and structure in India

- Evolution of Indian Banks
- Types of Banks
- Public Sector Banks, Private Sector Banks
- Regional Banks
- Performance of Public Sector Banks

Commercial Banking

- Structure, Functions, primary and secondary functions
- Role of commercial banks in socio economic development
- Services rendered by Commercial Banks
- Credit Creation and Deployment of Funds
- Role of Reserve Bank and GOI as regulator of Banking
- Provisions of Banking Regulation Act and Reserve Bank Act.



Introduction Of Banking Indus

The Banking Companies Act of 1949, defines :

Banking company as a company which transacts business of banking in India. It defines banking as, a for the purpose of lending or investment of deposit n from the public, repayable on demand or otherwise a withdraw able by cheque draft, order or otherwise.

A bank as an institution dealing in money and cred safeguard of the savings of the Public and gives loan advances.



Bank defined.....

A **bank** is a financial institution and a financial intermediary that accepts deposits and channels those deposits into lending activities, either directly by loaning or indirectly through capital markets. A bank is the connection between customers that have capital deficits and customers with capital surpluses.

Phases of Evolution of the Banking Industry

EVOLUTION OF THE INDIAN BANKING INDUSTRY

TRIGGER EVENTS

Beginning of institutional banking with 3 joint stock banks

Nationalisation of Imperial Bank and 20 other scheduled commercial banks

Acceptance of recommendations of the Narasimham Committee

Hike in the FDI ceiling for banking sector and declaration of roadmap for liberalisation

Phase 4 continues—more liberalisation expected

PHASES

Phase 1
Pre Nationalisation Phase

Phase 2
Era of Nationalisation and Consolidation

Phase 3
Introduction of Indian Financial & Banking Sector Reforms and Partial Liberalisation

Phase 4
Period of Increased Liberalisation

MAJOR CHANGES

- Birth of joint stock companies
- Introduction of d and bank branches
- Presidency banks stock banks form foundation of m system

- State Bank of India of imperial bank
- 20 SCBs national phases
- Directed credit p the rise
- Introduction of :

- Major changes in regulations
- Interest rates dere
- Statutory preemp eased more privat came in strengthen as a whole

- FDI ceiling for the increased to 74%
- Roadmap for incl banks declared
- More liberal bran policy followed



Indian Banking : Evolution

- ✦ Three presidency banks were established in Calcutta (1806 (1840) and in Madras (1843)
- ✦ In the early part of 20th century, on account of the Swadeshi number of joint stock banks were established by Indians like Bank of Baroda and Central Bank of India.
- ✦ In 1921 the three presidency banks were merged and the RBI of India was created.
- ✦ During the period 1900 to 1925 many banks failed, and the Government appointed in 1929 a Central Banking Enquiry Committee to find reasons for the failure of banks.
- ✦ The Reserve Bank of India Act was passed in 1934 and the RBI came into existence in 1935 and RBI was nationalised in 1949



Indian Banking : Evolution

- ✚ The Banking Regulation Act, 1949 gave wide powers to RBI to act as the regulator for banks in India.
- ✚ In 1955, State Bank of India became the successor to the Imperial Bank of India, under the State Bank of India Act, 1955.
- ✚ In 1959, State Bank of India (Subsidiary Banks) Act was passed to enable SBI to take over State Associated banks as SBI's subsidiaries.



Indian Banking : Evolution

- ✚ In 1969, the Government of India nationalised 14 commercial banks having deposits of Rs.50 crore or more.
- ✚ In 1975 Regional Rural Banks were established under the Regional Rural Banks Act 1976, which was preceded by RRB Ordinance in 1975.
- ✚ In 1980, six more commercial banks were nationalised under the Banking Companies (Acquisition and Transfer of Undertakings) Act 1980, which had a deposit of Rs.200 crore or more.



Progress of banking in India

✪ In the liberalized, privatized and globalized environment, banks operating in India have diversified their business activities by offering Para Banking facilities like

- Merchant banking/Mutual funds
- ATMs/Credit Cards/Internet banking
- Venture capital funds
- Factoring
- Bancassurance



Banking in India

- Banking in India is governed by BR Act and RBI Act, 1934
- Banking in India is controlled/monitored by RBI and Govt. of India
- The controls for different banks are different based on whether the bank/s is/are
 - a) statutory corporation
 - b) a banking company
 - c) a cooperative society



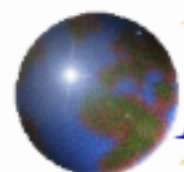
Banking Regulation Act, 1949 (BR Act)-1

- ✿ BR Act covers banking companies and cooperative banks, with certain modifications.
- ✿ BR Act is not applicable to
 - a) primary agricultural credit societies
 - b) land development banks
- BR Act allows RBI (Sec 22) to issue license for banks



Reserve Bank of India Act, 1935 (RBI Act)-1

- RBI Act was enacted to constitute the Reserve Bank of India
- RBI Act has been amended from time to time
- RBI Act deals with the constitution, powers and functions of RBI



Reserve Bank of India Act, 1935 (RBI Act)-2

RBI Act deals with:

- incorporation, capital management and business of banks
- central banking functions
- financial supervision of banks and financial institutions
- management of forex reserves
- control functions : bank rate, audit, accounts
- penalties for violation



Types Of Banking:

The principal banking institutions of a country may be divided into following types:

- ✿ (1) Central Banks
- ✿ (2) Commercial Banks
- ✿ (3) Industrial Or Development Banks
- ✿ (4) Exchange Banks (authorized dealers in foreign exchange)
- ✿ (5) Co-operative Banks
- ✿ (6) Agriculture & Rural development Banks
- ✿ (6) Indigenous Banks
- ✿ (7) International Banks



Central Banks

Central Bank is the bank of a country – a nation.

Its main function is to issue currency known as 'Bank

This bank acts as the leader of the banking system and market of the country by regulating money and credit

These banks are the bankers to the government; t
banker's banks and the ultimate custodian of a
foreign exchange reserves.

The aim of the Central Bank is not to earn profit,
maintain price stability and to strive for e
development with all round growth of the country.



Commercial Banks

A bank, which undertakes all kinds of ordinary banking business, is called a commercial



Industrial Banks or Financial Institutions

An Industrial Bank is one which specialises in providing loans and fixed capital to industrial concerns by subscribing to shares and debentures issued by public companies.



Exchange Banks (Authorised Dealers in Foreign Exchange):

These types of banks are primarily engaged in transactions involving foreign exchange. They deal in foreign bills of exchange imported and exported, export of bullion and otherwise participate in the financing of foreign trade.



Co-operative Banks

They are organized on co-operative principles of mutual help and assistance. They grant short-term loans to the agriculturists for purchase of seeds, fertilizers, harvesting and for other cultivation expenses. They accept money on deposit from and make loans to their members at a low rate of interest.



Land-mortgage Banks (Presently known as Agriculture and Rural Development Banks)

They are agriculture development banks. The Land-mortgage banks supply long-term loans for a period up to 10 years for development of land to improve agricultural yield. They also grant loan for permanent improvements in agricultural lands.

The National Bank for Agriculture and Rural Development (NABARD) was constituted by the Government to promote rural development.



Indigenous Banks

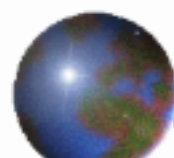
The Central Banking Enquiry Commission defines an indigenous banker as an individual or institution accepting deposits and dealing in indigenous lending of money to the needy.

They form an unorganized part of the banking structure, i.e., these are unrecognized operators receiving deposits and lending money.

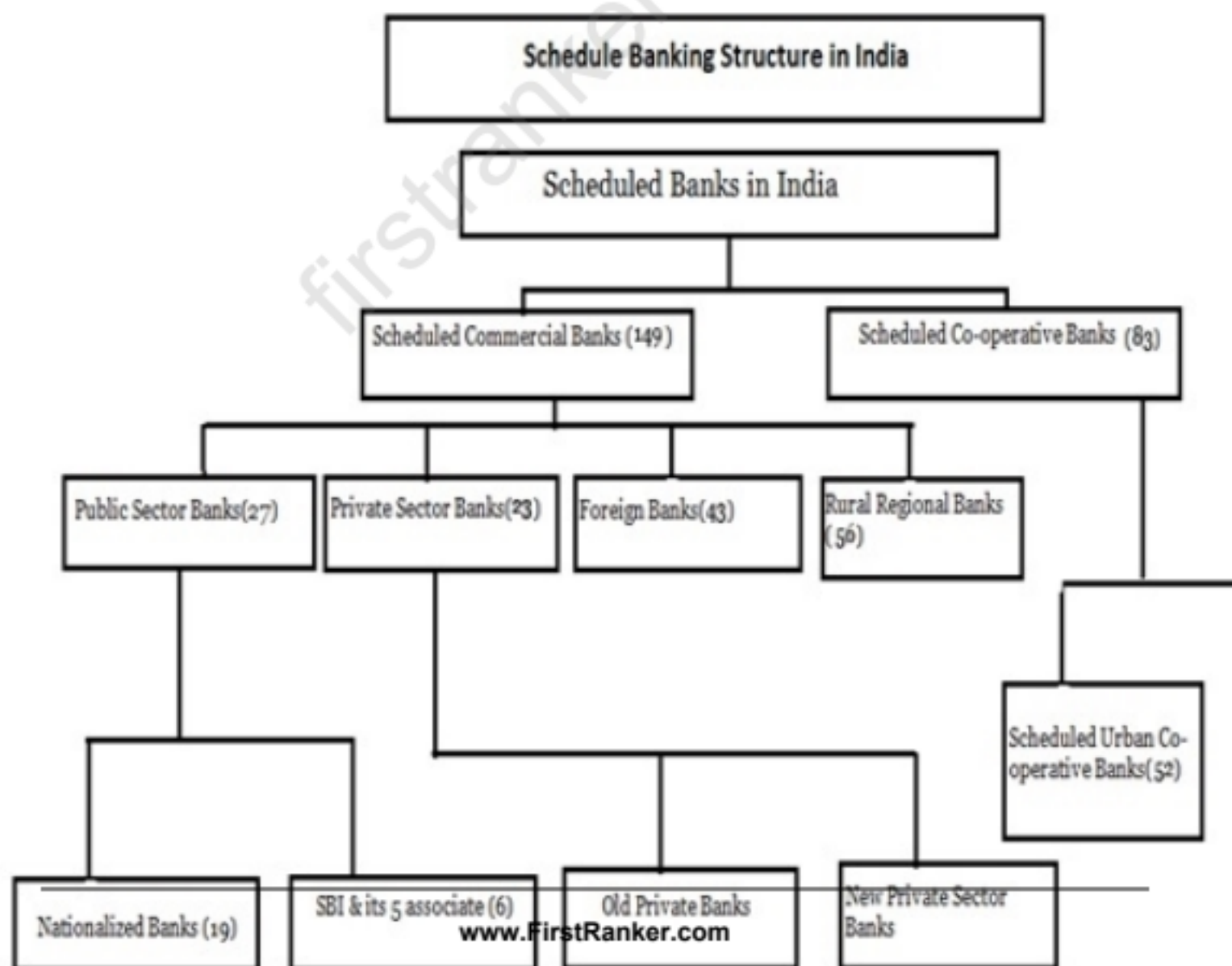


International Banks

International Banks are those which are operated in different countries. While, the registered office/head office is situated in one country, they operate through branches in other countries. They specialize in business pertaining to foreign trade like opening of letters of credit, providing short-term finance in foreign currencies, issue of performance guarantee, arranging currency credits, etc. They are the main traders of International Currencies like US 'dollars', Japanese Yen, the new-born European Currency 'Euro', etc.



Structure Of Indian Banking System





Scheduled Banks

Scheduled Banks are those banks which are listed in the Second Schedule to the Reserve Bank of India Act, 1935. Banks satisfying the following conditions are only included in the Second Schedule.

- ✦ (a) That the Bank's paid up capital plus free reserves is not less than Rs. 5.00 lakh, and
- ✦ (b) That the affairs of the Bank are not conducted in the detrimental interest of the depositors.
- ✦ The Reserve Bank also has powers to deschedule a bank if the abovementioned conditions are not satisfied.
- ✦ It may be noted presently, the RBI has prescribed a minimum paid up capital of Rs. 100 crores for starting a new commercial bank.



Non-scheduled Banks

Scheduled Banks are those banks which are notified by the Reserve Bank of India under the Second Schedule to the Reserve Bank of India Act, 1934.

- ✚ (a) These banks also need to maintain a statutory reserve with RBI
- ✚ (b) Their banking activities are limited. E.g) they cannot deal in foreign exchange



Public Sector Banks, Private Sector

Public sector bank refers to commercial banks which are owned by the central Government either directly or indirectly through the Reserve Bank of India.

They are also referred to National Banks.

Public sector banks comprise two categories.

- 1) State Bank Group
- 2) Nationalised Banks



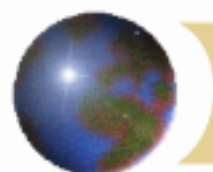
State Bank Group

- ❖ The history of nationalization of Indian banks dates the year 1955 when the Imperial Bank of India was nationalized and re-christened as State Bank of India (the SBI Act, 1955).
- ❖ Later on July 19, 1960, the 7 subsidiaries of SBI viz Bank of Hyderabad (SBH), State Bank of Indore, State Bank of Saurashtra (SBS), State Bank of Mysore (SBM), State Bank of Bikaner and Jaipur (SBBJ), State Bank of Patna (SBP), and State Bank of Travancore (SBT) were also nationalized with deposits more than 200 crores.



Nationalized Banks

Allahabad Bank
Andhra Bank
Bank of Baroda
Bank of India
Bank of Maharashtra
Canara Bank
Central Bank of India
Corporation Bank
Dena Bank
Indian Bank
Indian Overseas Bank
Oriental Bank of Commerce
Punjab & Sind Bank
Punjab National Bank
Syndicate Bank
UCO Bank
Union Bank of India
United Bank of India
Vijaya Bank



Private Sector Banks

Private sector banks are those commercial banks which are owned and controlled by private entrepreneurs.

This banks comprise two categories of banks

- 1) Private Sector Indian Banks
- 2) Private Sector Foreign Banks.



Regional Banks

- ✚ These are the banking organizations operating in different states of India.
- ✚ Created to serve the rural areas with banking financial services.
- ✚ However, RRB's may have branches set up for operations and their area of operation may include urban areas too.
- ✚ They are also referred to as Grameen Banks/ Banks. There are as many as 67 RRB's.



Functions

- ✚ The main purpose of RRB's is to mobilize financial resources from rural / semi-urban areas and
- ✚ grant loans and advances mostly to
 - ✚ small and marginal farmers,
 - ✚ agricultural laborers and
 - ✚ rural artisans.
- ✚ The area of operation of RRBs is limited to the area as notified by GoI covering one or more districts in the State.



COMMERCIAL BANKING



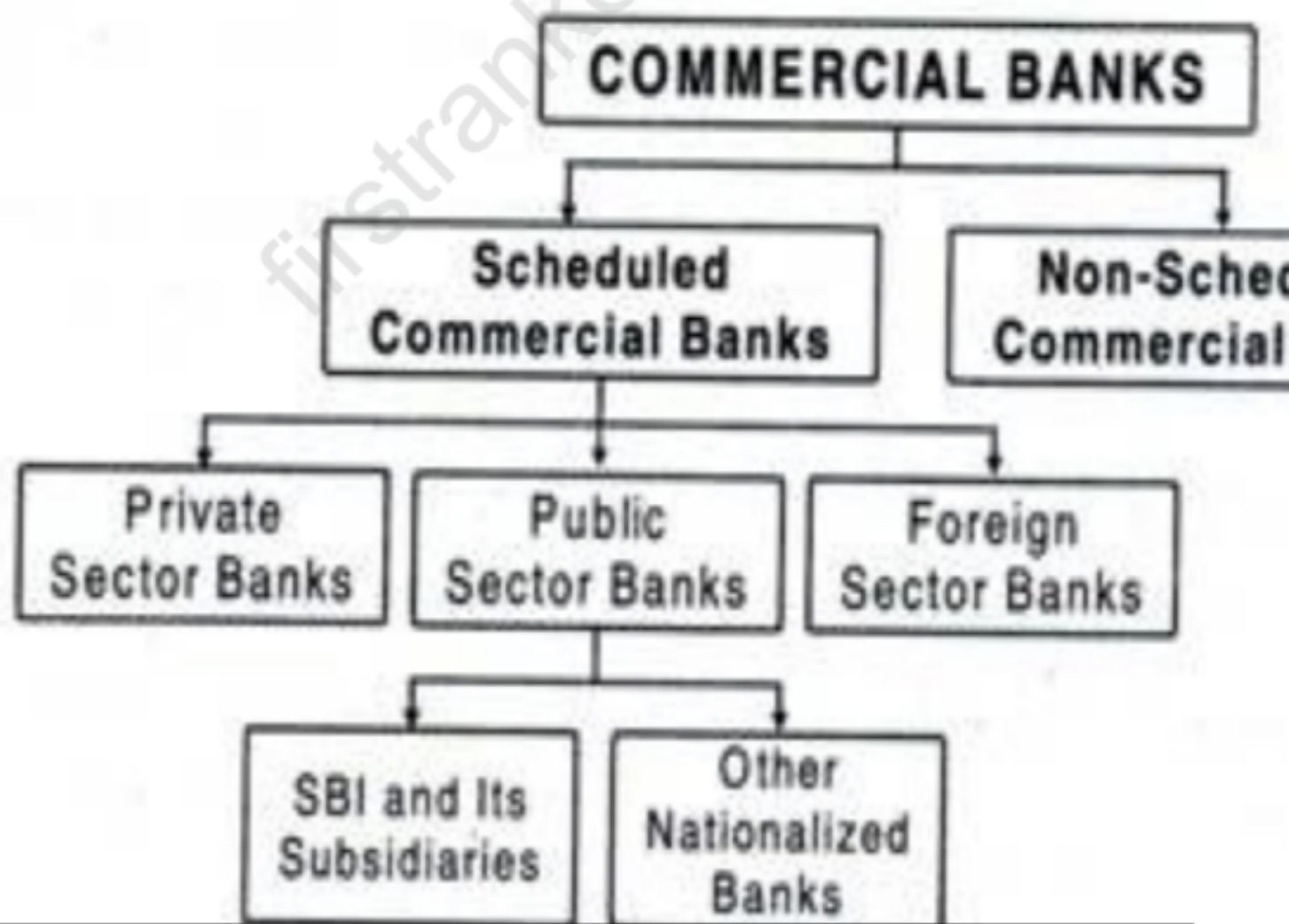
Commercial Banking Overview



- ➊ Commercial banks provide banking services to individuals, small businesses and large organizations



Structure Of Commercial Banks





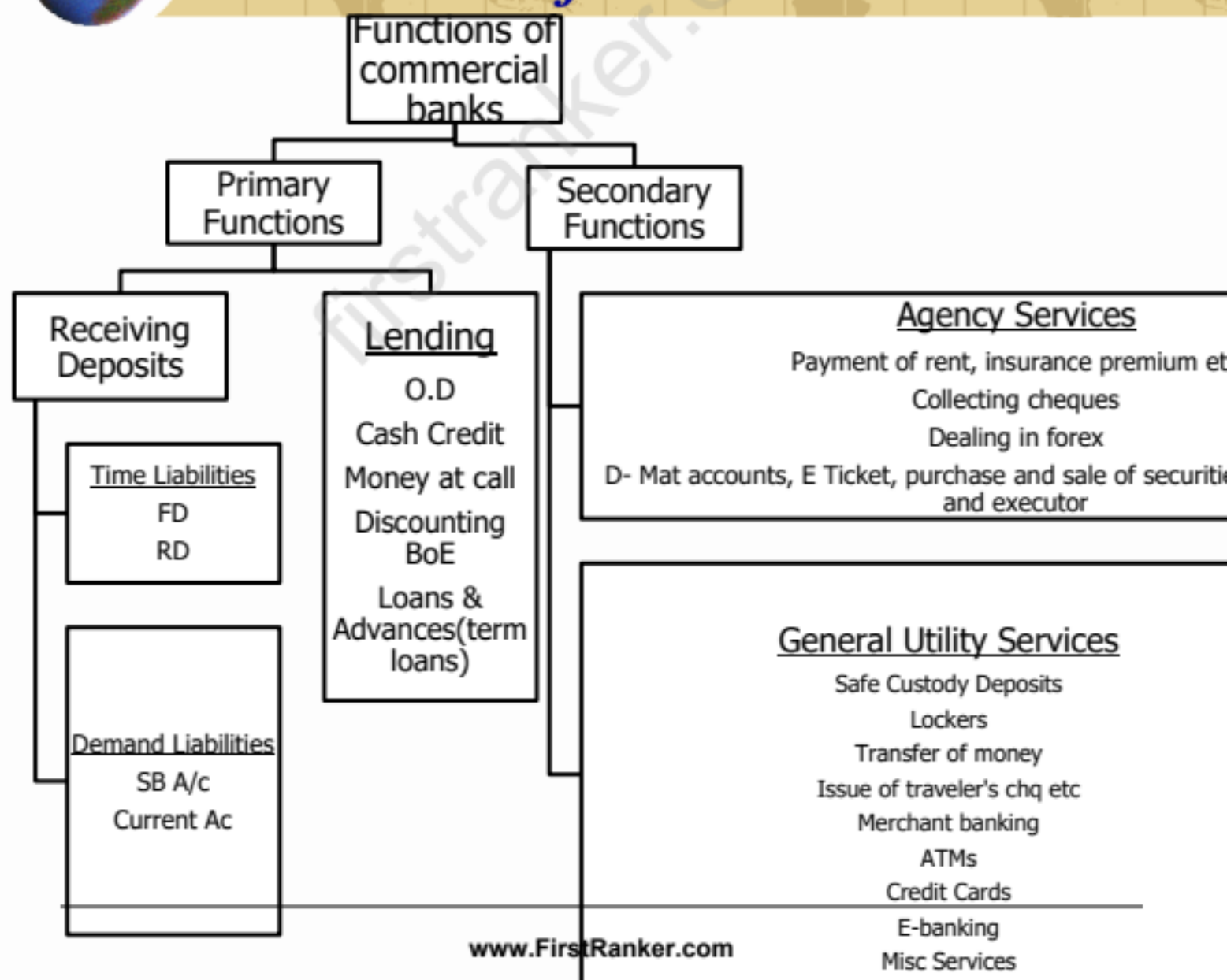
Commercial Banks

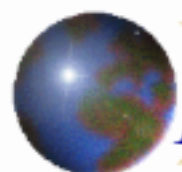


- Commercial banks comprising public sector banks, foreign banks, and private sector banks represent the most important financial intermediary in the Indian financial system.



Functions of a commercial bank





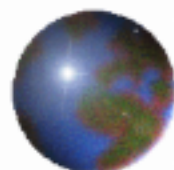
Role of commercial banks in socio economic development.

- ✿ Banks promote capital formation.
- ✿ Investment in new enterprise.
- ✿ Promotion of trade and industry.
- ✿ Development of agriculture.
- ✿ Balanced development of different regions.
- ✿ Implementation of monetary policy.
- ✿ Export promotion.
- ✿ Financing the priority sectors.



Continued...

- ✚ Assistance to agriculture and SSIs
- ✚ Assistance to women and students
- ✚ Control the trade cycle
- ✚ Catalyst to social change



Service Rendered by Commercial

1) Teller System

2) Plastic Money

3) Online Banking

4) Traveller's Cheque

5) Gifts Cheques

6) Telegraphic Transfer



Credit Creation:

- ✚ Important function of commercial banks.

The tendency on the part of commercial banks to expand their demand deposits by a multiple of their excess cash reserves is called creation of credit.



Credit Creation:

✪ Credit creation happens in two ways –

1. Primary deposits

- ✪ A normal deposit by the customer
- ✪ Debt to the bank
- ✪ Primary deposits bring cash into banking system

2. Derivative deposits

- ✪ Using the cash deposited the bank grants advances and bills, bonds etc
- ✪ While lending, the bank places the amount of loan in the account of borrower
- ✪ These deposits are derived from the primary deposits and known as derivative deposits



firstranker.com

CREDIT CREATION PROC



Limitations of credit creation

- ✚ Adequate cash reserve
- ✚ Availability of securities
- ✚ Quantity of money in circulation
- ✚ Banking habit of people
- ✚ Policy of the central bank
- ✚ Nature of business conditions
- ✚ Behavior of other banks



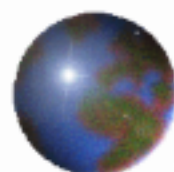
RESERVE BANK OF INDIA



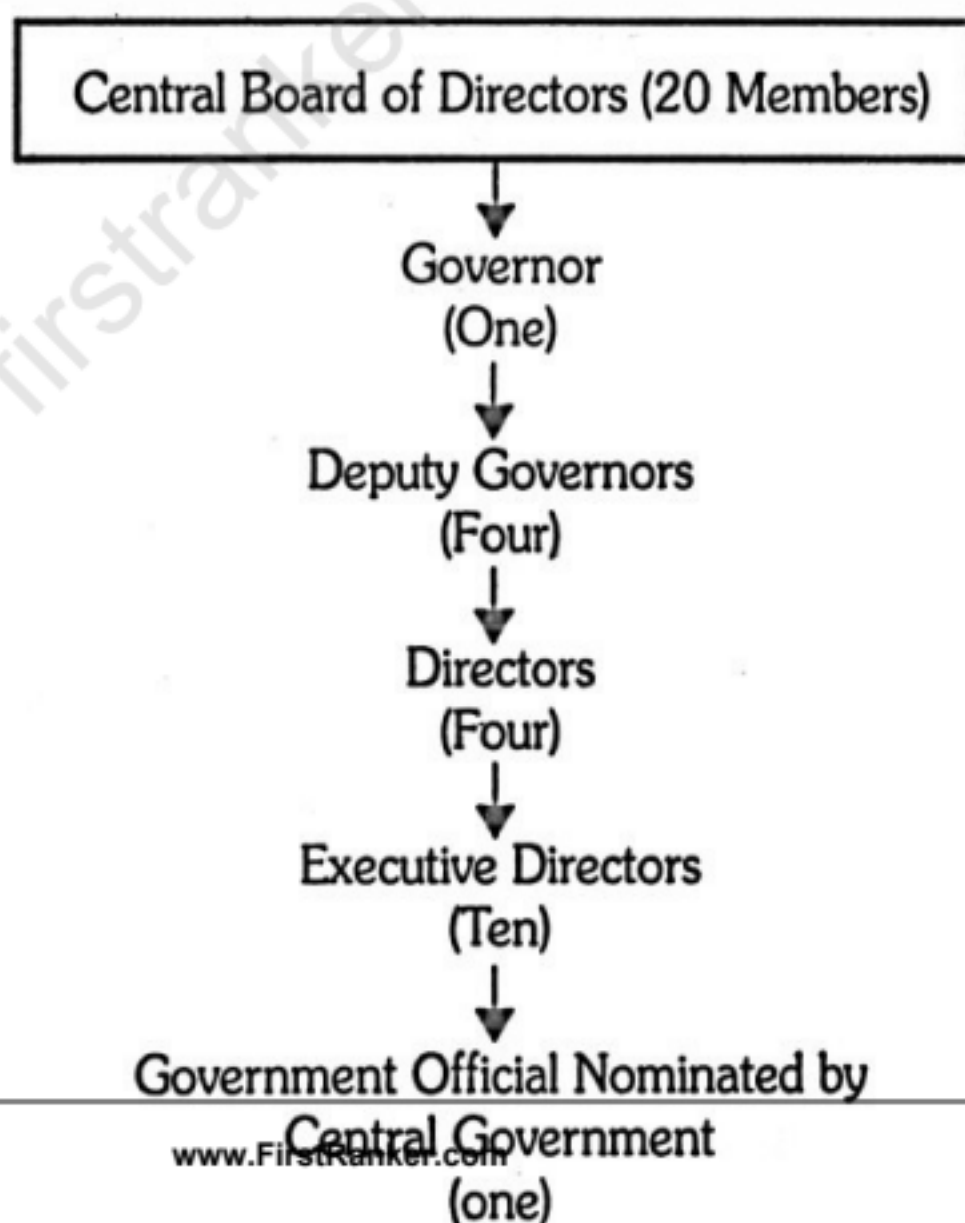


RBI

- ❖ The Reserve Bank of India Act 1934 was commenced on April 1, 1935. The Act, 1934 (II of 1934) provides the statutory basis of the functioning of the bank.
- ❖ The bank was constituted for the need of following:
 - To regulate the issue of banknotes.
 - To maintain reserves with a view to securing financial stability.
 - To operate the credit and currency system to the advantage of the country to its advantage.



Organizational Structure





Role of Reserve Bank and GOI as regulator of Banking system.

- ✚ **Bank regulations are a form of government regulation which subject banks to various requirements, restrictions and guidelines.**
- ✚ This regulatory structure creates transparency between banking institutions and the individuals and corporations with whom they conduct business, among other things.



Objectives of bank regulation

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



General principles of Bank regulation

- ⊕ Minimum requirements
- ⊕ Supervisory review
- ⊕ Market discipline



Role of Reserve Bank and GO regulator of Banking system.

- ✚ Controlling money supply in the system
- ✚ Monitoring different key indicators like interest rate and inflation.
- ✚ Maintaining people's confidence in the banking and financial system.
- ✚ Providing different tools for customer's



RBI is the issuer of Currency

- ✚ Section 22 of the RBI act gives authority to the RBI to issue currency notes.
- ✚ RBI also takes the control circulation of fake currency.



RBI is the issuer of Monetary

- ✿ RBI formulates the monetary policy twice a year and reviews the policy every quarter as well.
- ✿ The main objectives of monetary policy are:
 - ✿ Inflation control
 - ✿ Control on bank credit
 - ✿ Interest rate control
- ✿ Tools used for implementation of the objectives of Monetary Policy are:
 - ✿ CRR & SLR
 - ✿ Open market operations
 - ✿ Different rates such as repo rate, reverse repo rate and bank rate



RBI under takes supervisory r

- ☐ Issue of licence
- ☐ Prudential norms
- ☐ Corporate governance
- ☐ KYC norms
- ☐ Transparency Norms
- ☐ Risk Management
- ☐ Audit and inspection
- ☐ Foreign exchange control
- ☐ development



Principles of Banking

- ☐ Safety
- ☐ Liquidity
- ☐ Profitability



Provisions of Banking Regulation Act and Reserve Bank of India



Applicability of the Banking Regulation Act

- ✿ This Act applies to following categories of Banks:
- ✿ • Nationalized Banks
- ✿ • Non-Nationalized Banks
- ✿ • Cooperative Banks



Business of banking Companies Section 6(1) and 6(2) r.w. 56(b)

- ⊕ Borrowing, raising or taking of money
- ⊕ Giving advance
- ⊕ Bills business
- ⊕ L/C , Bank Guarantee, Indemnity
- ⊕ Foreign exchange
- ⊕ Providing safe deposit
- ⊕ Collecting and transmitting money
- ⊕ Managing, selling and realizing any property
may come into the possession of the bank
— satisfaction or part satisfaction of any of its dues



- Acquiring, holding and dealing with any property or any right, title or interest in any such property that may form the security or part of the security for any loans or advances or which may be connected with such security.
- Undertaking and executing trusts
- Acquiring, constructing, maintaining and repairing of any building for the purpose of the bank



- ✚ Doing all such other things as are incidental or conducive to the promotion or advancement of the business of the bank.
- ✚ Any other business the Central Govt. notification specify as a allowed business.
- ✚ Banks are prohibited to do any other business.



Cash Reserve (CRR) – Section 18 r. w

- ✚ Every bank is required to keep cash re with itself or by way of balance in the account with RBI or Central / District C operative Bank or net balance in all su of minimum prescribed % amount of it
- ✚ • A return about this has to be submit RBI before 15th of each month about a Friday.



Statutory Liquidity Ratio

- Bank shall maintain unencumbered approved securities, valued exceeding the current market price an amount which shall not be less than 24% of the total of its demand and time liabilities (DTL).



Restrictions on loans and advances

- ✦ (1) Notwithstanding anything to the contrary contained in section 77 of the Companies Act, 1956 (1 of 1956), no company shall,
 - ✦ • (a) grant any loans or advances on the security of shares, or
 - ✦ • (b) enter into any commitment for granting any advance to or on behalf of any of its directors,
 - ✦ • (ii) any firm in which any of its directors is interested, partner, manager, employee or guarantor, or
 - ✦ • (iii) any company [not being a subsidiary of the company or a company registered under section 25 of the Companies Act, 1956] in which any of the directors of the company is a director, managing agent, manager, employee, guarantor or in which he holds substantial interest, or
 - ✦ • (iv) Any individual in respect of whom any of its directors is a partner or guarantor.



Licensing of banking companies

- ✿ Save as hereinafter provided, no company shall carry on banking business in India unless it holds a license issued on its behalf by the Reserve Bank and any such license may be issued subject of such conditions as the Reserve Bank may think fit to impose.]
- ✿ Every banking company in existence on the commencement of this Act, before the expiry of six months from the commencement, and every other company before commencing banking business [in India], shall apply in writing to the Reserve Bank for a license under this section.



ASSIGNMENTS 1:

- ✦ 1. Define Banking. Dec.15/Jan16. (3 marks)
- ✦ 2. What are the types of banks? June/July 2016 (3 marks)
- ✦ 3. Explain the functions of commercial banks. June/July 2016
- ✦ 4. Discuss the role of commercial bank in socio economic dev
Dec.15/Jan16 (7 marks).
- ✦ 5. Explain the bank's basics of creation on assets. June/July 2
marks)
- ✦ 6. Explain the role of RBI & GOI as regulator of banking system
Dec.15/Jan16, June/July 2016 (10 marks)