

# **MODULE 6**

## **BANKER AS LENDER**

## **OUTLINE:**

- Banker as lender
- Types of loans
- Overdraft facilities
- Discounting of bills
- Financing book
- Debts and supply bills
- Charging of Security bills
- Pledge - Mortgage
- Assignment.

# INTRODUCTION:

- Lending is one of the important functions of all banks.

## **General Principles of Sound Lending**

- Safety
- Liquidity
- Profitability
- Security to be insisted upon
- Purpose of the loan
- Diversification of loans
- Assured Repayment
- Social Objectives

## **Forms of advances:**

- 1) Loans
- 2) Cash Credit
- 3) Over draft
- 4) Discounting of Bills
- 5) Hire purchase advances

## **1)Loans**

- Loans: lump sum amount is sanctioned to the customer for a specified time and specified rate of Interest. A separate account is opened in the name of the customer
- Short Term – less than one year
- Medium term – 1 to 5 years
- Long term – above 5 years

## **2) CASH CREDIT**

- Cash Credit : Under this system the customer is permitted to borrow money upto a particular limit against sufficient securities.
- A separate account is opened for this purpose. Deposits and withdrawals are frequently made in this account.
- It is very popular among large industrial houses.
- It is sanctioned for one year and renewed after.
- Interest is charged only on the amount utilized.

### **3) OVERDRAFT**

- Customer is allowed to overdraw his current account up to a specified limit
- Relatively it is not granted on a regular basis like cash credit. Interest is charged on the amount utilized

## **4) DISCOUNTING OF BILLS**

- Banker lends against the Promissory or a bill of exchange.
- It is granted to only the well known financial parties as it is a clean advance to the banks without any securities. Banker may also purchase the bill instead of discounting.

## **5) HIRE PURCHASE ADVANCES**

- Banks provide finances to companies engaged in hire purchase business.
- They don't finance to the final customer they do so they do it under the category personal loans.

# ***TYPES OF LOANS***

## ***Home Loan***

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

## **Some types of home loans are mentioned below**

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

## ***Personal Loan***

- This type of loan is given to individuals after assessing their credentials based on their profession or business or any other sources of income.
- The loan can be utilised for any purpose, for example, paying debt, marriage expenses or vacation expenses.
- No collateral security is required for this type of loan. The span of personal loan repayment varies from 12 months to 60 months depending upon the principal amount and the EMIs.
- The interest rate ranges from 15 percent to 28 percent, varying from bank to bank.
- Approximately 2 percent of the total loan amount is charged as the loan processing fee.

# ***Business Loan***

- This type of loan is provided to either existing businesses or those venturing into new business.
- As banks provide loans on the basis of individual's credentials, it is bit difficult to get a loan for starting a business.
- It is very important for individuals (starting a business) to have a clear cut business plan and this is the most important requirement to convince the banks that your business has the capability of repayment.

# ***Education Loan***

- Required by and provided to students who want to pursue higher education in resident country or abroad.
- Students should have an admission offer from a higher education institution before they apply for an education loan.
- The loan takes care of the fees of the institution including examination and library fees; travel expenses for abroad; cost of books and equipments required; insurance for the student, if applicable; and any other additional expenses such as tours, thesis, projects, etc.
- The terms of education loans vary from bank to bank.

## **RBI guidelines for Education Loan**

- The RBI has fixed certain norms on the total amount of loan that can be disbursed; however, banks can increase or decrease the limit depending on the institution.
- For studying in India, Rs. 10 lakh is the average and for studying abroad, the average is Rs. 15 lakh.
- For a loan amount up to Rs. 4 lakh, parents should be the joint borrowers and above that amount, a guarantee or some security in the form of tangible assets is required, depending upon the bank.
- Simple rate of interest is charged depending upon the base rate of the bank.

# Gold Loan

- Gold loan is imparted only on providing gold as security to a bank or any other lending institution.
- It is considered as one of the safest methods as the amount is provided on the basis of the security submitted.
- Amount ranging from Rs. 5k to 25 lakh can be taken as loan against gold.
- Amount equivalent to 80 percent to 90 percent (varies from bank to bank) of the total value of the gold is given as loan to the borrower.
- Depending upon the bank, the tenure of gold loan varies from one day to two years. The extension of tenure is also allowed by few banks.
- The rate of interest usually ranges from 14 percent to 24 percent, depending upon the financial institution.

- The banks charge processing fees of up to 1.5 percent.
- There is no prepayment fee. You can repay the gold loan any time during the tenure.
- EMI policy also varies from bank to bank. A few banks prefer EMIs where interest and principal are charged monthly, whereas a few only charge the interest on a monthly basis and offer flexibility for the payment of the interest amount.

# ***Vehicle/ Car Loan***

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

# Overdraft facilities

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

# ***Reasons for overdrafts***

- *Intentional short-term loan*
- *Failure to maintain an accurate account register*
- *ATM overdraft*
- *Temporary Deposit Hold*
- *Unexpected electronic withdrawals*
- *Merchant error*
- *Bank fees*

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

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

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

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

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

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

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

- Authorization holds - When a customer makes a purchase using their debit card without using their PIN, the transaction is treated as a credit transaction. The funds are placed on hold in the customer's account reducing the customer's available balance.

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

# ***Discounting of bills***

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

- The seller who is the holder of a accepted B/E has two options :
- 1. Hold on the B/E till maturity and then take the payment from buyer.
- 2. Discount the B/E with discounting agency.

- ***Discount:***

- ● Seller can take the accepted B/E to discounting agency and obtain ready money.
- ● The act of giving accepted B/E for ready money is call discounting the B/E.
- ● The difference between ready money paid and the face value of the bill is call the discount.

# ***Types of Bills***

- 1. Demand Bill
- 2. Usance Bill
- 3. Documentary Bill
- 4. Clean Bill

## ***Creation of a B/E***

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

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

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

- ***Type of Charges***

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

- Lien – right of the banker to retain possessions of the goods securities owned by the debtor until debt due is paid
- ⌚ Set-off – Total or partial merging of a claim of one person another in a counterclaim by the latter against the former.
- ⌚ Mortgage – Transfer of interest in immovable property to an advanced loan or an existing debt or performance of an obligation.
- ⌚ Pledge – Bailment of goods for providing security for pay debt or performance of promise.
- ⌚ Hypothecation – Charge upon any movable property created by borrower in favor of a secured creditor without delivery of possession of the movable property, also called as a mortgage of movable property.

- **Pledge**
- ⌚ Bailment of goods as security for payment of debt or performance of a promise :PLEDGE
- ⌚ Bailer: PAWNER
- ⌚ Bailee: PAWNEE
- ⌚ Example:
- ⌚ A borrows Rs.100 from B & keeps watch as security : pledge

- **Mortgage**

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

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

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

- **Assignment**

- 🕒 Essentially, an assignment is the transfer of ownership. An example of an assignment is when a person sells his or her car, thereby transferring the title to another.
- 🕒 When assigned, the option writer has an obligation to complete the requirements of the option contract. If the option was a call (put) option, then the writer would have to sell (buy) the underlying security at the stated strike

- **Example:**

- One example of assignment is 'transfer by the holder of a life insurance policy (the assignor) of the benefits and proceeds of the policy to a lender (the assignee), as collateral for a loan'. In such case in the event of the death of the assignor, the assignee is paid first and the balance (if any) is paid to the policy's beneficiary. However, insurance policies other than life insurance may not be used for this purpose.

# THANK YOU

