

Principles of Banking Module A

V. Rajendran

Venkrajen.in

venkrajen@yahoo.com

Indian Financial System

- Financial Market consists of Money market, debt market, forex market, capital market
- Debt market -> govt sec and bonds
- Bonds -> FI, PSU, Corporate
- Money market -> call, Treasury, CD, CP

Financial System -> Central Bkg, Capital Market
Regulatory and Insurance and pension
regulator

RBI functions

- RBI Constitution
- Functions :
 - Notes Issue
 - Govt Banker
 - Banker's bank
 - Bank Supervision : licences, appointments, merger

Monetary Control tools

- CRR (scheduled and non-scheduled) % of DTL
- Pay penal interest for the period of shortfall
- Cut in CRR enhances loanable funds
- SLR is Cash in hand, cur A/c with SBI and other public sector coml banks, unencumbered approved govt securities
- Bank Rate: RBI buys or discounts bills
- Open Market Operations
- Selective Credit Control

Retail Banking, Wholesale Banking

- Individuals segment, both liabilities and assets
 - Multiple products (deposits, cards, insurance)
 - Multiple channels (branches, ATMs, internet)
 - Multiple groups (small business, corporate etc)
 - Retail deposits and loan products
- Wholesale banking: Corporate and commercial
- International Banking
- Universal banking: cross-sell, insurance etc

Capital Market

- Long term debt and equity shares
- Primary market
- Secondary market
- Stock exchanges and their role
- Demutualisation of stock exchanges
- Stock brokers
- Types of products and shares

Types of capital market

- IPO
- FPO and its
- Rights Issue
- Bonus Issue
- Eligibility for marking capital issues
- Red-herring prospectus
- Issue pricing: intermediaries, price discovery

SEBI

- Regulators for stock market
- Register venture capital funds
- Promote investors education, regulating orgns
- Prohibit unfair practices
- Inspection of books and records
- Civil court powers to inspect, summon, record
- Powers to investigate
- Registration of stock brokers, sub-brokers

Mutual funds

- Pooling resources by issuing units, invest in funds as per offer document
- SEBI formulates the policies
- Open ended and close ended
- Growth and equity oriented
- Income and debt oriented
- Balanced funds
- Sector specific funds
- Tax Savings

Insurance

- Insurance and banking as part of nation building
- The four major insurance companies
- Types of insurance business
- Contract of insurance is the basis
- Types: Life (different variants) and General
- Role of IRDA

Factoring and forfaiting

- Factoring: financing and collection of receivables
- Domestic factoring normally 150 days
- International factoring: imports and exports and involves steps like evaluation, collection etc
- Forfaiting: exporters signs a contract, arranges for LC, involves other documentation like invoice, shipping documents etc

Off Balance items

- Contingent liabilities to be disclosed as Notes to the Balance Sheet
- When crystallised, they become part of the B.S.
- Transaction related items eg bonds, warranties, financial guarantees, stand-by LCs, forward asset purchases, sale and repurchase agreements, take-out finance on taking over, aggregating outstanding foreign exchange contracts

Letter of Credit - Parties

Undertaking given by the bank

- Buyer applies for LC and is the importer
- Opening bank/branch
- Seller also called shipper or beneficiary

Types of LC:

- Revocable (not in use now) and irrevocable
- Revolving LC

Letter of Guarantee

- Financial guarantee (an advance or EMD or amount to be paid to government or other bodies as a contractual obligation)
- Performance guarantee (to pay the monetary loss arising out of the non-fulfillment of task and liability is always monetary only)
- Deferred payment guarantee (purchase of machinery, cash payment of say 10% and gets accepted bills payable over a period of time)

Risk Management

- Definition of risk
- Loan Review mechanism
- Credit Risk, Market risk and Operation risk
- Basel – I uniform to all CRAR 9%
- Minimum capital requirement calculated as a factor taking into account trading risk, off-balance items, market risks etc

Basel II

- Basel Committee on Banking Supervision
- Three pillars:
 - Minimum capital requirements based on credit risk, (three approaches standardised, internal ratings and securitisation framework), operational risk and market risk
 - Supervisory review process: process to assess overall capital adequacy, evaluate, monitor etc
 - Market discipline: disclosure requirements

Capital elements

- Tier 1 shareholders' equity
- Tier 2 undisclosed reserves, revaluation reserves, general provisions used for standardised approach, subordinated term debts including unsecured capital instruments
- Tier 3 short-term debt covering market risk limited to 250% of tier 1 capital

Alliances, Mergers

- Alliance: mutual agreement, strategic like technology, training, scale escalation etc
- Merger: combining two with one surviving with original name and the other losing it and may be horizontal or vertical depending on products or services
- Consolidation: two existing companies and a new company getting formed

CIBIL

- Repository of information – Originally started by SBI, HDFC and now owned by various banks
- Minimises instances of concurrent and serial defaults by providing credit information
- Database as received from members
- Serves as Credit Information Reports helping in loan disbursement

Fair Practices for Debt Collection

- Need for it – off-shoot of SARFESI which made the RBI to evolve the code
- Loans and their processing
- Loan appraisal terms and conditions
- Disbursement of loans and changes in terms
- Post disbursement supervision
- IBA's Bankers' Fair Practice code in June 2004

Banking Codes and Standards Board of India

- SS Tarapore Committee Nov 2003
- Formed as a society in February 2006
- Serves as a watch-dog for the industry
- Fair Practices Code for Credit Card Operations
- These are different from Banking Ombudsman
- Member banks of Code of Banks' Commitment to Customers (July 2006) are not bound by the voluntary codes of IBA (B.F.P. Code, FPC for Cr Card Operations, Model Code for Collcn and repossession of security)