II Year

NON- MAJOR ELECTIVE - I : BANKING PRACTICES

Unit I

The development of British Banking

1. Royal Exchanger
   - In England, Edward III, Exchanged the foreign coins for travellers an merchants
2. The Goldsmiths – started banking
3. Early Beginning of “Issue” and “Deposit” Banking
4. Current account

Growth / History of Indian Banking Industry

Phase I

- General Bank of India set up 1786 – followed by Bank of Hindustan and Bengal Bank
- East India Company established bank of Bengal 1809
- Then Bombay bank 1840
- Bank of Madras 1843
- All three banks amalgamated in 1920 – Imperial Bank established
- Punjab National bank ltd – 1894 for Indian
- RBI in 1935

Phase II

- 1955, 14 comm. Bank nationalized
- 1980 banking reforms carried out

Phase III

- 1991 ATM

Origin of the Bank

1. BANCK- German word- it means -Joint Stock Fund
2. BANCO- Italy- குவியல் Heap of money
3. BANCUS/BANQUE-French-Bench
4. BANK- English-Financial intermediary that accepts deposits and channels those deposits into lending activities.

Banking Definition

Section 5(b) of the Banking Companies Act, 1949 defines banking as “accepting deposits from the public, repayable on demand and withdrawable by cheque, draft, order or otherwise”.

"Whatever a bank does is called Banking"

Classification of Banks

1. Commercial banks
   - Aim of earning profit
   - Accept deposit – short term (3 to 6 months) loans to traders
   - OD and credit facilities to their customers
2. Investment or industrial banks
   - Accept long term deposits
   - Credit requirements of industries by extending LT loans
   - Sale and purchase of shares and debentures
3. Foreign exchange banks
   - Foreign trade
   - Main function is to discount, accept, and collect foreign bills of exchange.
   - Sell foreign currency
4. Agricultural banks
   - Credit to farmers, ST, MT & LT loans
   - Two types of banks: a. Agriculture Co-operative Banks,
   - b.Land Mortage Banks
   - agricultural co-operative banks are mainly for short periods.
5. Savings banks
   - Encourage small savers
   - Accept small sums as deposits
   - Encourage poor and middle class people
6. Co-operative banks
   - Helping among the members
   - Functions: loans, deposits, banking accounts
7. Central bank
   - Control, regulate and stabilize the banking and monetary system of the country.
   - Central Bank, Reserve Bank or Monetary Authority is a) Issue the currency, b) regulate the money supply c) controls the interest rates

Role / Importance of Banks or
Economic and Monetary Implications of Modern Banking Operations

1. Deposit mobilization
2. Credit creation
3. Monetization of Economy
4. Encouragement to Right type of Industries
5. Developing of Agriculture
6. Implementation of bank rate or monetary policy
7. Balanced regional development
8. Promote industrial development
9. Finance to Government
10. Bankers as employers
11. Innovations and diversification of business

Economic Development through Banking System

1. Employment
2. Income
3. Savings
4. Investment
5. Production
6. Consumption
7. Industrial Development

FORMS OF DEPOSITS

1. Current Accounts : Special Features

   a. Convenience
   b. Collect the bills, drafts, cheques etc
   c. No charges
   d. Certain privileges:
      i. Third party cheques with endorsement deposited in the current account
      ii. OD Facilities
      iii. The loans and advances granted

2. Savings Accounts: Person Eligible to Open a Savings Account

1. Any individual or own behalf
2. More than one person
3. A minor
4. Secretaries, Treasurers, Manager or other officers of non-trading concerns
5. Trading concern

Features of Savings Account

1. Min. 500 Rs.
2. 25 withdrawals
3. Less min. Bal. Rs.10 service charges
4. Withdrawal exceeds
5. The amount exceeds
6. Savings interest ½ %

3. Fixed Deposits Accounts / Receipts : Features

1. It’s a negotiable instrument not transferred

2. it can assigned
3. Cheques cannot be drawn against FD receipts
4. Duly signed by the customer
5. If lost, money can be claimed by court's orders.
6. It made jointly by many persons
7. Limitation period

4. Recurring Deposits

OPENING OF CURRENT AND SAVINGS BANK ACCOUNTS

1. Application on the Prescribed Form
2. Introduction of the applicant

Risk in opening accounts without proper introduction

a. The banker cannot avail of the Statutory protection
b. Risk in case of overdrafts
c. Risk in case of undischarged insolvent
d. Risk in case of issue of Bogus(false) cheques

Forms Used in the Operation of Account

1. The pay-in-slip book
2. The cheque book, and
3. The pass book

Difference between Savings Account Vs. Current Account

Sl. No.	Features	Savings Account	Current Account
1	Who prefers it	Salaried people	Business people
2	Privileges	Enjoys limited privileges such as collection of cheques, safe custody of valuables, etc	Enjoys more privileges
3	Withdrawal	Withdrawal is limited with regard to period and amount	No such limitation
4	Interest	Carries a nominal rate of interest	Usually does not carry any interest

5	Objectives	To promote thrift and banking habits	Business transaction
6	Minimum balance	Rs.500	Rs.1,000
7	Overdraft	Not available	Available
8	Reserves	No need to hold reserves in proportion to the volume of deposits	There is a need to hol reserves in proportion to the volume of deposits.

CLOSING OF A BANK ACCOUNT

1. If a customer writing to close
2. Un operated account
3. Banker terminate the account
4. Death of a customer
5. Banker receives a notice regarding the insanity (lunatic) of his customer
6. Insolvent or liquidation
7. Garnishee order from the Court
8. Banker received notice to settle the amount to third party.

PROCEDDURES FOR OPENING A NEW ACCOUNT IN THE CASE OF SPECIAL CUSTOMERS

I. MINOR

Precautions to be taken by a banker:

1. Opening the account
2. Date of Birth
3. Loan to a Minor
4. Guarantees
5. Minor as a party to a negotiable instrument. Sec. 26
6. Minor as a partner. Sec. 30 (7)
7. Minor as an Agent
8. Minor as a Witness
9. Safe Custody Articles
10. Stock and Shares

II. MARRIED WOMEN

Precautions to be taken by a banker:

1. Name and address of the husband
2. Operate the account only sufficient balance
3. Not grant an OD
4. Advance agreement with husband
5. Before granting loan or OD better for the banker to require her to sign a "**Free Will**" clause.

III. LUNATICS

Precautions to be taken by a banker:

1. Not opening a/c – if knowing
2. Customer who was sane – when he knows immediately close the a/c
3. If banker suspending

IV. TRUSTEES

Precautions to be taken by a banker:

1. Trust deed
2. Rights and duties of the trustees
3. The beneficiary and the extent of benefits due
4. Borrowing powers
5. Duration of the trustees
6. Identification of the trust property
7. The value of the trust properly
8. The loan granted – signed by all the trustees
9. Insolvency of the trustee – not affect his position
10. Letter of appointment before operate the account
11. Cheque drawn by trust must contain the seal of the trust
12. Specimen signature of the trustees

V. PARTNERSHIP FIRM

Precautions to be taken by a banker:

1. Number of Partners
2. Title of firm's a/c
3. Opening of an account
4. The partnership letter or mandate

a. Name and address
b. Nature of business
c. Name of the partner who operate the a/c

5. Revocation(withdraw) of authority to operate the account
6. Delegation of authority
7. Cheque endorsed by a partner in his favour
8. Implied authority of a partner
9. Admission of a new partner
10. Insolvency of a partner
11. Retirement of a partner
12. Lunacy of a partner
13. Alterations in the constitution of a Firm

VI. JOINT STOCK COMPANIES

Steps to be taken in opening an Account

1. Certificate of incorporation – Registrar of Joint Stock Companies
2. Memorandum and Articles of Association copies
3. Certificate of commerce business from Registrar certifying
4. B/S and P&L a/c copies
5. Newly started companies look the Articles of Association
6. Resolution of the Board appointing

Precautions to be taken by a banker:

1. The borrowing powers of the company
2. Provisions in the Company's Act, 1956 – Board of Directors
3. Delegation of powers
4. Ultra vires the Memorandum

5. Winding up – receiving the notice of resolution
6. Sec.125 of the Companies Act, 1956 gives a list of charges requiring registration

RESERVE BANK OF INDIA

- RBI is the central banking institution of India
- Controls the monetary policy of the rupee as well as US $
- Established on 1st April 1935
- Aim development strategy of the Govt.
- The central bank was founded in 1935 to respond to economic troubles after the First World War.
- RBI set up – recommendations of the Hilton Young Commission.
- Submitted report in 1926
- First office at Kolkatta, Bengal – then permanently move to Mumbai in 1937.
- Originally set up as a shareholders' bank, its owned by the Govt. Of India since its nationalization in 1949

Objectives of the Reserve Bank of India

1. Free from political influence & successful operation for maintaining financial stability and credit.
2. To discharge purely central banking functions
3. To assist the planned process of development of the Indian economy.

Main Functions of RBI

I. Central Banking Functions / Primary Functions

1. Monopoly of Note Issue
2. Banker's Bank
3. Banker to Govt. Agent and Advisor
4. Regulation of Foreign Exchange
5. Clearing houses Function
6. Lender of the Last Resort
7. Compilation of Statistics
8. Custodian of Foreign Exchange Reserves

II. Promotional Functions

1. Promotion of Banking Habit
2. Providing Refinance for Exports
3. Providing Credit to Agriculture
4. Providing Credit to small scale Industrial Units
5. Providing Indirect Finance to Cooperative Sector

6. Exercising Control Over Monetary and Banking Systems of the Country
7. Making Institutional Arrangement for Industrial Finance

III. Supervisory / Regulatory Functions

1. Licensing of Banks
2. Inspection of Banks
3. Deposit Insurance
4. Control Over Banks
5. Giving Training and Educating the Banking Personnel
6. Control of NBFCs

IV. Other Functions

1. Controller of Credit
2. Role of Development
3. Promotion of Savings
4. Publication of Information

Need for Central Banking

1. Control of Credit
2. Issue of Paper Currency
3. Supporting Commercial Banks
4. Implementation of Monetary Policy

Management Persons of Central Banking

1. Chairman & Managing Director – Rajeev Rishi
2. Executive Director – 2 person – B.K. Divakara, P. Ramana Murthy
3. Director – GOI – Dr.Saurabh Garg,
   RBI – Shri Shekhar
   Shareholder – Shri Supratim
   Shareholder – Shri Ketul
4. Part Time Non Official Director under Chartered Account Category – N. Nityananda

Nature of Central Banking

1. The Central Bank **does not aim at profits but aims at national welfare**.
2. The Central Bank **does not compete with the member banks**.
3. The Central Bank has **special relationship with government** and with commercial banks.
4. The Central Bank is generally **free from political influence**.
5. The Central Bank is the **apex body of the banking** structure of the country.
6. The Central Bank should have **overall control over the financial system**.

Difference between Central Banking and Commercial Banking

S.No.	Feature	Central Banking	Commercial Banking
1.	Bank status	Apex Bank – which control other banks like RBI	Constituent bank in the banking system
2.	Ownership	Central Govt.	Private or Public
3.	Primary motive	Economic growth	Profit making
4.	Dealing with public	Does not deal with public	Deal with public
5.	Competition	No competition	Competition among commercial banks
6.	New Issue	Note issue	No authority
7.	Custodian	Foreign exchange	Custodian of valuable of customers
8.	Banker	Banker to the Govt.	Bankers to the public
9.	Cash reserve ratio	Not required	Required
10.	Lender of last resort	Help commercial banks	Availing credit
11.	Clearing house	Acts as clearing house	No such function
12.	Regulation	Controls and regulates	No such responsibility

UNIT – II

What is Commercial Bank?

A commercial bank is a kind of financial institution which carries all the operations related to deposit and withdrawal of money for the general public, providing loans for investment, etc. These banks are profit-making institutions and do business only to make a profit.

The two primary characteristics of a commercial bank are lending and borrowing. The bank receives the deposits and gives money to various projects to earn interest (profit). The rate of interest that a bank offers to the depositors are known as the borrowing rate, while the rate at which banks lends the money is called the lending rate.

Functions of Commercial Banks

The two most distinctive features of a commercial bank are borrowing and lending, i.e., acceptance of deposits and lending of money to projects to earn Interest (profit). In short, banks borrow to lend. The rate of interest offered by the banks to depositors is called the borrowing rate while the rate at which banks lend out is called lending rate.

The difference between the rates is called 'spread' which is appropriated by the banks. Mind, all financial institutions are not commercial banks because only those which perform dual functions of (i) accepting deposits and (ii) giving loans are termed as commercial banks. For example post offices are not bank because they do not give loans. Functions of commercial banks are classified in to two main categories—(A) Primary functions and (B) Secondary functions.

Let us know about each of them:

(A) Primary Functions:

1. It accepts deposits:

A commercial bank accepts deposits in the form of current, savings and fixed deposits. It collects the surplus balances of the Individuals, firms and finances the temporary needs of commercial transactions. The first task is, therefore, the collection of the savings of the public. The bank does this by accepting deposits from its customers. Deposits are the lifeline of banks.

Deposits are of three types as under:

(i) Current account deposits:

Such deposits are payable on demand and are, therefore, called demand deposits. These can be withdrawn by the depositors any number of times depending upon the balance in the account. The bank does not pay any Interest on these deposits but provides cheque facilities. These accounts are generally maintained by businessmen and Industrialists who receive and make business payments of large amounts through cheques.

(ii) Fixed deposits (Time deposits):

Fixed deposits have a fixed period of maturity and are referred to as time deposits. These are deposits for a fixed term, i.e., period of time ranging from a few days to a few years. These are neither payable on demand nor they enjoy cheque facilities.

They can be withdrawn only after the maturity of the specified fixed period. They carry higher rate of interest. They are not treated as a part of money supply Recurring deposit in which a regular deposit of an agreed sum is made is also a variant of fixed deposits.

(iii) Savings account deposits:

These are deposits whose main objective is to save. Savings account is most suitable for individual households. They combine the features of both current account and fixed deposits. They are payable on demand and also withdraw able by cheque. But bank gives this facility with some restrictions, e.g., a bank may allow four or five cheques in a month. Interest paid on savings account deposits in lesser than that of fixed deposit.

Difference between demand deposits and time (term) deposits:

Two traditional forms of deposits are demand deposit and term (or time) deposit:

(i) Deposits which can be withdrawn on demand by depositors are called demand deposits, e.g., current account deposits are called demand deposits because they are payable on demand but saving account deposits do not qualify because of certain conditions on withdrawal. No interest is paid on them. Term deposits, also called time deposits, are deposits which are payable only after the expiry of the specified period.

(ii) Demand deposits do not carry interest whereas time deposits carry a fixed rate of interest.

(iii) Demand deposits are highly liquid whereas time deposits are less liquid,

(iv) Demand deposits are chequable deposits whereas time deposits are not.

2. It gives loans and advances:

The second major function of a commercial bank is to give loans and advances particularly to businessmen and entrepreneurs and thereby earn interest. This is, in fact, the main source of income of the bank. A bank keeps a certain portion of the deposits with itself as reserve and gives (lends) the balance to the borrowers as loans and advances in the form of cash credit, demand loans, short-run loans, overdraft as explained under.

(i) Cash Credit:

An eligible borrower is first sanctioned a credit limit and within that limit he is allowed to withdraw a certain amount on a given security. The withdrawing power depends upon the borrower's current assets, the stock statement of which is submitted by him to the bank as the basis of security. Interest is charged by the bank on the drawn or utilised portion of credit (loan).

(ii) Demand Loans:

A loan which can be recalled on demand is called demand loan. There is no stated maturity. The entire loan amount is paid in lump sum by crediting it to the loan account of the borrower. Those like security brokers whose credit needs fluctuate generally, take such loans on personal security and financial assets.

(iii) Short-term Loans:

Short-term loans are given against some security as personal loans to finance working capital or as priority sector advances. The entire amount is repaid either in one instalment or in a number of instalments over the period of loan.

Investment:

Commercial banks invest their surplus fund in 3 types of securities:

(i) Government securities, (ii) Other approved securities and (iii) Other securities. Banks earn interest on these securities.

(B) Secondary Functions:

Apart from the above-mentioned two primary (major) functions, commercial banks perform the following secondary functions also.

3. Discounting bills of exchange or bundles:

A bill of exchange represents a promise to pay a fixed amount of money at a specific point of time in future. It can also be encashed earlier through discounting process of a commercial bank. Alternatively, a bill of exchange is a document acknowledging an amount of money owed in consideration of goods received. It is a paper asset signed by the debtor and the creditor for a fixed amount payable on a fixed date. It works like this.

Suppose, A buys goods from B, he may not pay B immediately but instead give B a bill of exchange stating the amount of money owed and the time when A will settle the debt. Suppose, B wants the money immediately, he will present the bill of exchange (Hundi) to the bank for discounting. The bank will deduct the commission and pay to B the present value of the bill. When the bill matures after specified period, the bank will get payment from A.

4. Overdraft facility:

An overdraft is an advance given by allowing a customer keeping current account to overdraw his current account up to an agreed limit. It is a facility to a depositor for overdrawing the amount than the balance amount in his account.

In other words, depositors of current account make arrangement with the banks that in case a cheque has been drawn by them which are not covered by the deposit, then the bank should grant overdraft and honour the cheque. The security for overdraft is generally financial assets like shares, debentures, life insurance policies of the account holder, etc.

Difference between Overdraft facility and Loan:

(i) Overdraft is made without security in current account but loans are given against security.

(ii) In the case of loan, the borrower has to pay interest on full amount sanctioned but in the case of overdraft, the borrower is given the facility of borrowing only as much as he requires.

(iii) Whereas the borrower of loan pays Interest on amount outstanding against him but customer of overdraft pays interest on the daily balance.

5. Agency functions of the bank:

The bank acts as an agent of its customers and gets commission for performing agency functions as under:

(i) Transfer of funds:

It provides facility for cheap and easy remittance of funds from place-to-place through demand drafts, mail transfers, telegraphic transfers, etc.

(ii) Collection of funds:

It collects funds through cheques, bills, bundles and demand drafts on behalf of its customers.

(iii) Payments of various items:

It makes payment of taxes. Insurance premium, bills, etc. as per the directions of its customers.

(iv) Purchase and sale of shares and securities:

It buys sells and keeps in safe custody securities and shares on behalf of its customers.

(v) Collection of dividends, interest on shares and debentures is made on behalf of its customers.

(iv) Acts as Trustee and Executor of property of its customers on advice of its customers.

(vii) Letters of References:

It gives information about economic position of its customers to traders and provides similar information about other traders to its customers.

6. Performing general utility services:

The banks provide many general utility services, some of which are as under:

(i) Traveller’s cheques .The banks issue traveler’s cheques and gift cheques.

(ii) Locker facility. The customers can keep their ornaments and important documents in lockers for safe custody.

(iii) Underwriting securities issued by government, public or private bodies.

(iv) Purchase and sale of foreign exchange (currency).

Credit (Money) Creation by Commercial Banks (A10; D10, 10C, 11, 11C):

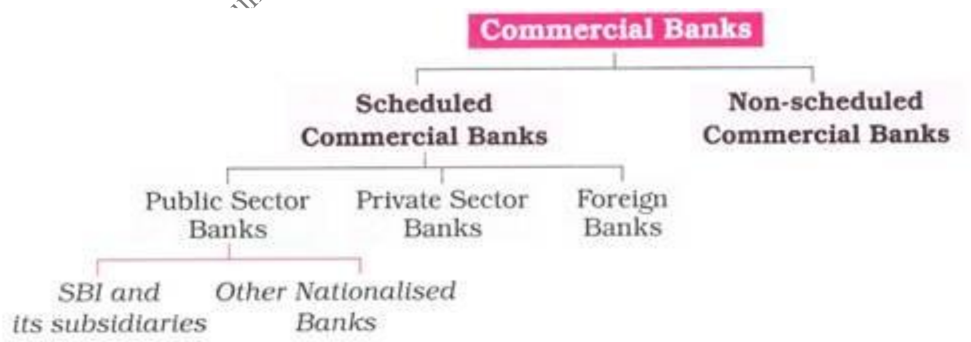
RBI produces money while commercial banks increase the supply of money by creating credit which is also treated as money creation. Commercial banks create credit in the form of secondary deposits.

Mind, total deposits of a bank is of two types:

(i) Primary deposits (initial cash deposits by the public) and (ii) Secondary deposits (deposits that arise due to loans given by the banks which are assumed to be redeposited in the bank.) Money creation by commercial banks is determined by two factors namely (i) Primary deposits i.e. initial cash deposits and (ii) Legal Reserve Ratio (LRR), i.e., minimum ratio of deposits which is legally compulsory for the commercial banks to keep as cash in liquid form. Broadly when a bank receives cash deposits from the public, it keeps a fraction of deposits as cash reserve (LRR) and uses the remaining amount for giving loans. In the process of lending money, banks are able to create credit through secondary deposits many times more than initial deposits (primary deposits).

Types of Commercial Banks:

The following chart depicts main types of commercial banks in India.



Scheduled Banks and Non-scheduled Banks:

Commercial banks are classified in two broad categories—scheduled banks and non-scheduled banks.

Scheduled banks are those banks which are included in Second Schedule of Reserve Bank of India. A scheduled bank must have a paid-up capital and reserves of at least Rs 5 lakh. RBI provides special facilities including credit to scheduled banks. Some of important scheduled banks are State Bank of India and its subsidiary banks, nationalised banks, foreign banks, etc.

Types of Commercial Bank:

There are three different types of commercial bank.

- **Private Bank –** It is one type of commercial banks where private individuals and businesses own a majority of the share capital. All private banks are recorded as companies with limited liability. Such as Housing Development Finance Corporation (HDFC) Bank, Industrial Credit and Investment Corporation of India (ICICI) Bank, and Yes Bank etc.
- **Public Bank –** It is those type of bank that is nationalised, and the government holds a significant stake. For example, Bank of Baroda, State Bank of India (SBI), Dena Bank, Corporation Bank, and Punjab National Bank.
- **Foreign Bank –** These banks are established in foreign countries and have branches in other countries. For instance, American Express Bank, Hong Kong and Shanghai Banking Corporation (HSBC), Standard & Chartered Bank, and Citibank etc.

Examples of Commercial Bank

Few examples of commercial bank in India are.

- State Bank of India (SBI)
- Housing Development Finance Corporation (HDFC) Bank
- Industrial Credit and Investment Corporation of India (ICICI) Bank
- Dena Bank
- Corporation Bank

Non-scheduled Banks:

The banks which are not included in Second Schedule of RBI are known as non-scheduled banks. A non-scheduled bank has a paid-up capital and reserves of less than Rs 5 lakh. Clearly, such banks are small banks and their field of operation is also limited.

A passing reference to some other types of commercial banks will be informative.

Industrial Banks provide finance to industrial concerns by subscribing (buying) shares and debentures of companies and also give long-term loans to acquire machinery, plants, etc. Foreign Exchange Banks are commercial banks which are branches of foreign banks and facilitate international financial transactions through buying and selling of foreign bills.

Agricultural Banks finance agriculture and provide long-term loans for buying tractors and installing tube-wells. Saving Banks mobilise small savings of the people in savings account, e.g., Post office saving bank. Cooperative Banks are organised by the people for their own collective benefits. They advance loans to their members at fair rate of interest.

Significance of Commercial Banks:

Commercial banks play such an important role in the economic development of a country that modern industrial economy cannot exist without them. They constitute nerve centre of production, trade and industry of a country. In the words of Wick-sell, “Bank is the heart and central point of modern exchange economy.”

The following points highlight the significance of commercial banks:

(i) They promote savings and accelerate the rate of capital formation.

(ii) They are source of finance and credit for trade and industry.

(iii) They promote balanced regional development by opening branches in backward areas.

(iv) Bank credit enables entrepreneurs to innovate and invest which accelerates the process of economic development.

(v) They help in promoting large-scale production and growth of priority sectors such as agriculture, small-scale industry, retail trade and export.

(vi) They create credit in the sense that they are able to give more loans and advances than the cash position of the depositor’s permits.

(vii)They help commerce and industry to expand their field of operation.

(viii) Thus, they make optimum utilisation of resources possible.

Commercial Banks in India

In India, there is mixed banking system. The booked business banks would the individual’s banks which are included in the second calendar of RBI enactment in 1934. Furthermore which do those typical benefits of the business about saving money for example, tolerating deposits, providing for crazy credits?

In 1969, there were 14 major commercial banks that deposits 50 crores of capital for being nationalized. Later in 1980 six more banks were nationalized. In present, 20 commercial banks are nationalized and SBI and its seven subsidiaries constituting public sector banks that controls over ninety percent of the banking business in India.

Modern Commercial Banks deals with the merchant banking, money lending or traders issued documents like ‘Hundi’. Modern banks issues cheques, on demand drafts, etc. Commercial Banks are considered as the most important source of institutional credit majorly in money market and deals with short term finance.

BOOKS FOR REFERENCE:

❖Gorden and Natarajan “Banking Theory Laws Practice”, Himalaya Publishing House, New Delhi, 2018.

❖Santhanam B, “Banking Theory Law & Practice”, Margham Publications, Chennai, 2018.