MANAGEMENT OF FINANCIAL INSTITUTIONS AND SERVICES

(MBA-FM-3 4TH SEM)

Unit I: Introduction: Financial System & Markets

Constituent of Financial Systems & Markets: A 'financial system' is a system that allows the exchange of funds between financial market participants such as lenders, investors, and borrowers. Financial systems operate at national and global levels. They consist of complex, closely related services, markets, and institutions intended to provide an efficient and regular linkage between investors and depositors.

Money, credit, and finance are used as medium of exchange in financial systems. They serve as a medium of known value for which goods and services can be exchanged as an alternative to bartering. A modern financial system may include banks (public sector or private sector), financial markets, financial instruments, and financial services. Financial systems allow funds to be allocated, invested, or moved between economic sectors. They enable individuals and companies to share the associated risks.

The components of a financial system

Financial institutions

Banks

Banks are financial intermediaries that lend money to borrowers to generate revenue and accept deposits . They are typically regulated heavily, as they provide market stability and consumer protection. Banks include:

- Public banks
- Commercial banks
- Central banks
- Cooperative banks
- State-managed cooperative banks
- State-managed land development banks

Non-bank financial institutions

Non-bank financial institutions facilitate financial services like investment, risk pooling, and market brokering. They generally do not have full banking licenses. Non-bank financial institutions include:

- Finance and loan companies
- Insurance companies
- Mutual funds
- Commodity traders

Financial markets

Financial markets are markets in which securities, commodities, and fungible items are traded at prices representing supply and demand. The term "market" typically means the institution of aggregate exchanges of possible buyers and sellers of such items.

Primary markets

The primary market (or initial market) generally refers to new issues of stocks, bonds, or other financial instruments. The primary market is divided in two segment, the money market and the capital market.

Secondary markets

The secondary market refers to transactions in financial instruments that were previously issued.

Financial instruments

Financial instruments are tradable financial assets of any kind. They include money, evidence of ownership interest in an entity, and contracts.

Cash instruments

A cash instrument's value is determined directly by markets. They may include securities, loans, and deposits.

Derivative instruments

A derivative instrument is a contract that derives its value from one or more underlying entities (including an asset, index, or interest rate).

Financial services

Financial services are offered by a large number of businesses that encompass the finance industry. These include credit unions, banks, credit card companies, insurance companies, stock brokerages, and investment funds

RBI- Role and Functions:

The **Reserve Bank of India** (**RBI**) is India's central bank, which controls the issue and supply of the Indian rupee. RBI is the regulator of the entire Banking in India. RBI plays an important part in the Development Strategy of the Government of India.

RBI regulates commercial banks and non-banking finance companies working in India. It serves as the leader of the banking system and the money market. It regulates money supply and credit in the country. The RBI carries out India's monetary policy and exercises supervision and control over banks and non-banking finance companies in India. RBI was set up in 1935 under the Reserve Bank of India Act, 1934.

Functions & Roles

The central bank of any country executes many functions such as overseeing monetary policy, issuing currency, managing foreign exchange, working as a bank for government and as a banker of scheduled commercial banks. It also works for overall economic growth of the country. The preamble of the Reserve Bank of India describes its main functions 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.

Financial supervision

The primary objective of RBI is to undertake consolidated supervision of the financial sector comprising commercial banks, financial institutions, and non-banking finance companies.

The board is constituted by co-opting four directors from the Central Board as members for a term of two years and is chaired by the governor. The deputy governors of the reserve bank are ex-officio members. One deputy governor, usually the deputy governor in charge of banking regulation and supervision, is nominated as the vice-chairman of the board. The board is required to meet normally once every month. It considers inspection reports and other supervisory issues placed before it by the supervisory departments.

Regulator and supervisor of the financial system

The institution is also the regulator and supervisor of the financial system and prescribes broad parameters of banking operations within which the country's banking and financial system functions. Its objectives are to maintain public confidence in the system, protect depositors' interest and provide cost-effective banking services to the public. The *Banking Ombudsman Scheme* has been formulated by the Reserve Bank of India (RBI) for effective addressing of complaints by bank customers. The RBI controls the monetary supply, monitors economic indicators like the gross domestic product and has to decide the design of the rupee banknotes as well as coins.

Regulator and supervisor of the payment and settlement systems

Payment and settlement systems play an important role in improving overall economic efficiency. The Payment and Settlement Systems Act of 2007 (PSS Act)[55] gives the Reserve Bank oversight authority, including regulation and supervision, for the payment and settlement systems in the country. In this role, the RBI focuses on the development and functioning of safe, secure and efficient payment and settlement mechanisms. Two payment systems National Electronic Fund Transfer (NEFT) and Real-Time Gross Settlement (RTGS) allow individuals, companies and firms to transfer funds from one bank to another. These facilities can only be used for transferring money within the country.

Banker and debt manager to government

Just as individuals need a bank to carry out their financial transactions effectively and efficiently. Government also need a bank to carry out their financial transactions. The RBI serves this purpose for the Government of India (GoI). As a banker to the Government of India, the RBI maintains its accounts, receive payments into and make payments out of these accounts. The RBI also helps the GoI to raise money from the public via issuing bonds and government-approved securities. In Sep 2019, a decision at RBI directors meet was taken to change the RBI financial accounting year to March–April to align itself with the central government calendar instead of the current June–July year.

Managing foreign exchange

The central bank manages to reach different goals of the *Foreign Exchange Management Act, 1999*. Their objective is to facilitate external trade and payment and promote orderly development and maintenance of foreign exchange market in India.

With the increasing integration of the Indian economy with the global economy arising from greater trade and capital flows, the foreign exchange market has evolved as a key segment of the Indian financial market and the RBI has an important role to play in regulating and managing this segment. The RBI manages forex and gold reserves of the nation.

Issue of currency

Other than the Government of India, the Reserve Bank of India is the sole body authorised to issue banknotes in India.

The bank also destroys banknotes when they are not fit for circulation. All the money issued by the central bank is its monetary liability, i.e., the central bank is obliged to back the currency with assets of equal value, to enhance public confidence in paper currency. The objectives are to issue banknotes and give the public adequate supply of the same, to maintain the currency and credit system of the country to utilise it in its best advantage, and to maintain the reserves.

The RBI maintains the economic structure of the country so that it can achieve the objective of price stability as well as economic development because both objectives are diverse in themselves.

For the printing of notes, RBI uses four facilities:[59]

- The Security Printing and Minting Corporation of India Limited (SPMCIL), a wholly owned company of the Government of India, has printing presses at Nashik, Maharashtra and Dewas, Madhya Pradesh.
- The Bharatiya Reserve Bank Note Mudran Private Limited (BRBNMPL), owned by the RBI, has printing facilities in Mysore, Karnataka and Salboni, West Bengal.

For the minting of coins, SPMCIL has four mints at Mumbai, Noida, Kolkata and Hyderabad for coin production.

Regulation of Money & Credit

Monetary Regulation and Credit Management of the RBI: The Reserve Bank of India is mainly constituted as an apex authority for monetary management.

Credit control is an important tool used by Reserve Bank of India, a major weapon of the monetary policy used to control the demand and supply of money (liquidity) in the economy. Central Bank administers control over the credit that the commercial banks grant. Such a method is used by RBI to bring "Economic Development with Stability". It means that banks will not only control inflationary trends in the economy but also boost economic growth which would ultimately lead to increase in real national income stability. In view of its functions such as issuing notes and custodian of cash reserves, credit not being controlled by RBI would lead to Social and Economic instability in the country.

Methods of credit control

There are two methods that the RBI uses to control the money supply in the economy-

- Qualitative method
- Quantitative method

During the period of inflation Reserve Bank of India tightens its policies to restrict the money supply, whereas during deflation it allows the commercial bank to pump money in the economy.

Qualitative method

By *Quality* we mean the uses to which bank credit is directed. Qualitative method controls the manner of channelizing of cash and credit in the economy. It is a 'selective method' of control as it restricts credit for certain section where as expands for the other known as the 'priority sector' depending on the situation.

Marginal requirement

Marginal requirement of loan current value of security offered for ban-value of loans granted. The marginal requirement is increased for those business activities, the flow of whose credit is to be restricted in the economy.

For Example:- A person mortgages his property worth ₹ 1,00,000 against loan. The bank will give loan of ₹ 80,000. The marginal requirement here is 20%

Rationing of credit

Under this method there is a maximum limit to loans and advances that can be made, which the commercial banks cannot exceed. RBI fixes ceiling for specific categories. Such rationing is used for situations when credit flow is to be checked, particularly for speculative activities. Minimum of "capital: total assets" (ratio between capital and total asset) can also be prescribed by Reserve Bank of India.

Publicity

RBI uses media for the publicity of its views on the current market condition and its directions that will be required to be implemented by the commercial banks to control the unrest. Though this method is not very successful in developing nations due to high illiteracy existing making it difficult for people to understand such policies and its implications.

Direct Action

Under the banking regulation Act, the central bank has the authority to take strict action against any of the commercial banks that refuses to obey the directions given by Reserve Bank of India. There can be a restriction on advancing of loans imposed by Reserve Bank of India on such banks. e.g. – RBI had put up certain restrictions on the working of the Metropolitan co-operative banks. Also the 'Bank of Karad' had to come to an end in 1992.

Moral Suasion

This method is also known as "moral persuasion" as the method that the Reserve Bank of India, being the apex bank uses here, is that of persuading the commercial banks to follow its directions/orders on the flow of credit. It also be part of meetings between RBI and Commercial Banks. RBI persuades the commercial bank to follow their policies. RBI puts a pressure on the commercial banks to put a ceiling on credit flow during inflation and be liberal in lending during deflation.

Quantitative method

By quantitative credit control we mean the control of the total *quantity* of credit.

Different tools used under this method are-

Bank rate

Bank rate also known as the discount rate is the official minimum rate at which the central bank of the country is ready to re discount approved bills of exchange or lend on approved securities.

Section 49 of the Reserve Bank of India Act 1934, defines Bank Rate as "the standard rate at which it (RBI) is prepared to buy or re-discount bills of exchange or other commercial paper eligible for purchase under this Act".

When the commercial bank for instance, has lent or invested all its available funds and has little or no cash over and above the prescribed minimum, it may ask the central bank for funds.

It may either re-discount some of its bills with the central bank or it may borrow from the central bank against the collateral of its own promissory notes.

In either case, the central bank accommodates the commercial bank and increases the latter's cash reserves. This Rate is increased during the times of inflation when the money supply in the economy has to be controlled.

Monetary and Fiscal Policies

Monetary Policy:

monetary policy is a tool used to either stimulate an economy or to check its growth. By incentivizing individuals and businesses to borrow and spend, the monetary policy aims to spur economic activity. Conversely, by restricting spending and incentivizing savings, monetary policy can act as a brake on inflation and other issues associated with an overheated economy.

Monetary policy is more of a blunt tool in terms of expanding and contracting the money supply to influence inflation and growth and it has less impact on the real economy. For example, the Fed was aggressive during the Great Depression. Its actions prevented deflation and economic collapse but did not generate significant economic growth to reverse the lost output and jobs.

Monetary policy addresses interest rates and the supply of money in circulation, and it is generally managed by a central bank.

Fiscal Policy
Generally speaking, the aim of most government fiscal policies is to target the total level of spending, the total composition of spending, or both in an economy. The two most widely used means of affecting fiscal policy are changes in government spending policies or in government tax policies.

If a government believes there is not enough business activity in an economy, it can increase the amount of money it spends, often referred to as stimulus spending. If there are not enough tax receipts to pay for the spending increases, governments borrow money by issuing debt securities such as government bonds and, in the process, accumulate debt. This is referred to as deficit spending.

Fiscal policy addresses taxation and government spending, and it is generally determined by government legislation.

Techniques of Regulation:

Financial regulation is a form of regulation or supervision, which subjects financial institutions to certain requirements, restrictions and guidelines, aiming to maintain the stability and integrity of the financial system. This may be handled by either a government or non-government organization. Financial regulation has also influenced the structure of banking sectors by increasing the variety of financial products available. Financial regulation forms one of three legal categories which constitutes the content of financial law, the other two being market practices and case law.

Supervision of stock exchanges

Exchange acts ensure that trading on the exchanges is conducted in a proper manner. Most prominent the pricing process, execution and settlement of trades, direct and efficient trade monitoring.

Supervision of listed companies

Financial regulators ensure that listed companies and market participants comply with various regulations under the trading acts. The trading acts demands that listed companies publish regular financial reports, ad hoc notifications or directors' dealings. Whereas market participants are required to publish major shareholder notifications. The objective of monitoring compliance by listed companies with their disclosure requirements is to ensure that investors have access to essential and adequate information for making an informed assessment of listed companies and their securities.

Supervision of investment management

Asset management supervision or investment acts ensures the frictionless operation of those vehicles.

Supervision of banks and financial services providers

Banking acts lay down rules for banks which they have to observe when they are being established and when they are carrying on their business. These rules are designed to prevent unwelcome developments that might disrupt the smooth functioning of the banking system. Thus ensuring a strong and efficient banking system.

Overview of Foreign Exchange Market

The **foreign exchange market** (**Forex**, **FX**, or **currency market**) is a global decentralized or over-the-counter (OTC) market for the trading of currencies. This market determines foreign exchange rates for every currency. It includes all aspects of buying, selling and exchanging currencies at current or determined prices. In terms of trading volume, it is by far the largest market in the world, followed by the credit market.[1]

The main participants in this market are the larger international banks. Financial centers around the world function as anchors of trading between a wide range of multiple types of buyers and sellers around the clock, with the exception of weekends. Since currencies are always traded in pairs, the foreign exchange market does not set a currency's absolute value but rather determines its relative value by setting the market price of one currency if paid for with another. Ex: US$1 is worth X CAD, or CHF, or JPY, etc.

The foreign exchange market works through financial institutions and operates on several levels. Behind the scenes, banks turn to a smaller number of financial firms known as "dealers", who are involved in large quantities of foreign exchange trading. Most foreign exchange dealers are banks, so this behind-the-scenes market is sometimes called the "interbank market" (although a few insurance companies and other kinds of financial firms are involved). Trades between foreign exchange dealers can be very large, involving hundreds of millions of dollars. Because of the sovereignty issue when involving two currencies, Forex has little (if any) supervisory entity regulating its actions.

The foreign exchange market assists international trade and investments by enabling currency conversion. For example, it permits a business in the United States to import goods from European Union member states, especially Eurozone members, and pay Euros, even though its income is in United States dollars. It also supports direct speculation and evaluation relative to the value of currencies and the carry trade speculation, based on the differential interest rate between two currencies.[2]

In a typical foreign exchange transaction, a party purchases some quantity of one currency by paying with some quantity of another currency.

The modern foreign exchange market began forming during the 1970s. This followed three decades of government restrictions on foreign exchange transactions under the Bretton Woods system of monetary management, which set out the rules for commercial and financial relations among the world's major industrial states after World War II. Countries gradually switched to floating exchange rates from the previous exchange rate regime, which remained fixed per the Bretton Woods system.

The foreign exchange market is unique because of the following characteristics:

- its huge trading volume, representing the largest asset class in the world leading to high liquidity;
- its geographical dispersion;
- its continuous operation: 24 hours a day except for weekends, i.e., trading from 22:00 GMT on Sunday (Sydney) until 22:00 GMT Friday (New York);
- the variety of factors that affect exchange rates;
- the low margins of relative profit compared with other markets of fixed income; and
- the use of leverage to enhance profit and loss margins and with respect to account size.

As such, it has been referred to as the market closest to the ideal of perfect competition, notwithstanding currency intervention by central banks.

According to the Bank for International Settlements, the preliminary global results from the 2019 Triennial Central Bank Survey of Foreign Exchange and OTC Derivatives Markets Activity show that trading in foreign exchange markets averaged $6.6 trillion per day in April 2019. This is up from $5.1 trillion in April 2016. Measured by value, foreign exchange swaps were traded more than any other instrument in April 2019, at $3.2 trillion per day, followed by spot trading at $2 trillion.

Financial Sector Reforms in India

In India, a decade old on-going financial reforms have transformed the operating environment of the finance sector from an “administrative regime to a competitive market base system”.

Since mid-1991, a number of reforms have been introduced in the financial sector in India. Rangrajan once noted that domestic financial liberalisation has brought about “the deregulation of interest rates, dismantling of directed credit, reforming the banking system, improving the functioning of the capital market, including the government securities market”. The main emphasis on the financial sector reform has been on the banking system so as to improve the performance of public sector banks. The Narasimhan Committee constituted in 1991 laid the foundation for the revamping of the financial sector in India. The Committee had submitted two reports- in 1992 and 1998 which gave immense importance on enhancing the efficiency and viability of this sector.

Taking a cue from the developments in the finance sector taking place globally, India undertook structural changes by way of these reforms and successfully relaxed the external constraints in its operation i.e. reduction in Cash Reserve Ratio and Statutory Liquidity Ratio, capital adequacy reforms, restructuring and recapitulation of banks and enhancement in the competitive element in the market through the entry of new banks. Banks in India had to give a go-by to their traditional operational methods of directed credit, fixed interest rates and directed investments, all of which, had the effect of deteriorating the quality of loan portfolios and inadequacy of capital and erosion of profitability.

Another prominent consequence of the reforms was the sprouting up of a number of banks due to the entry of new private and foreign banks, increased transparency in the banking system through the introduction of prudential norms and increase in the role of the market forces due to the deregulated interest rates. All these measures lead to major changes in the operational environment of the finance sector.

The objective of this paper is to analyse the financial sector reforms that have been carried out in India since the 1990s. The first chapter analyses the objectives of the reforms in the financial sector. Chapter II goes on explain in detail the policy reforms undertaken in this sector and puts forth a four-pronged approach to understand the various elements within the financial sector which have undergone changes. This is followed by Chapter IV which essentially recognises the elements integral to the reformation process. It includes the suggestions made by Y.V. Reddy. Finally, the penultimate chapter concludes the submissions and the analysis made in this research paper.

The primary objective of financial sector reforms in the 1990s was to “create an efficient, competitive and stable that could contribute in greater measure to stimulate growth”. [9] Economic reform process took place amidst two serious crises involving the financial sector:

The crisis involving the balance of payments that had threatened the international credibility of the country and dragged it towards the brink of default.

The crisis involving the grave threat of insolvency threatening the banking system which had concealed its problems for years with the aid of defective accounting policies.

Apart from the above two dilemmas, there were many deeply rooted problems of the Indian economy in the early 1990s which were strongly related to the finance sector. Prevalent amoung these were:

As mentioned by McKinnon and Shaw, till the early 1990s, the Indian financial sector could be described as an example of financial repression. The sector was characterised by administered interest rates fixed at unrealistically low levels, large pre-emption of resources by authorities and micro regulations which direct the major flow of funds back and forth from the financial intermediaries. The act of the government involving large scale pre-emption of resources from the banking system to finance its fiscal deficit. More than necessary structural and micro-regulation that inhibited financial innovation and increased transaction costs.

Relatively inadequate level of prudential regulation in the financial sector. Inadequately developed debt and money markets. Obsolete and out-dated technological and institutional structures that lead to the consequent inefficiency of the capital markets and the rest of the financial system.

Till the early 1990s, the Indian financial system was characterised by extensive regulations viz. administered interest rates, weak banking structure, directed credit programmes, lack of proper accounting, risk management systems and lack of transparency in operations of major financial market participants. Furthermore, this period was characterised by the restrictive entry of foreign banks since after the nationalisation of banks in 1969 and 1980, almost 90 per cent of the banking assets were under the control of government owned banks and financial institutions. The financial reforms initiated in this era attempted to overcome these weaknesses with the view of enhancing efficient allocation of resources in the Indian economy.

The Reserve Bank of India had been making efforts since 1986 to develop efficient and healthy financial markets which were accelerated after 1991. RBI focused on the development of financial markets especially the money market, government securities market and the forex markets. Financial markets also benefited from close coordination between the Central Government and the RBI as also between the other regulators.

On a general understanding, there are three groups of reform measures that are used to handle the problems faced by the financial sector. These are that of removal of financial repression, rehabilitation of the banking system and lastly, deepening and development of capital markets.

The focal issues addressed by financial sector reforms in India have primarily aimed to include the following:

Removal of the problem of financial repression. Creation of an efficient, profitable and healthy financial sector. Enabling the process of price discovery by market determination of interest rates which leads to an improvement in the efficiency in the allocation of resources.

Providing institutions with greater operational and functional autonomy. Prepping up the financial system for international exposure and competition. Introduction of private equity in public sector banks and their listing. Opening up of the external sector in a regulated manner. Promoting financial stability in the back-drop of domestic and external shocks.

To overcome the economic crisis that plagued the Indian economy in May 1991, the government undertook extensive economic reform policies that brought along with them an era of privatization, deregulation, globalisation and most importantly, liberalisation.

The financial reforms since the 1990s can be classified into two phases. The first phase, also known as the first generation reforms, was aimed at the creation of an efficient, productive, profitable and healthy financial sector which would function in an environment of functional autonomy and operational flexibility. The first phase was initiated in 1992 based on the recommendations of the Committee on Financial System. While the early phase of reforms was being implemented, the global economy was also witnessing prominent changes coinciding with the movement towards global integration of financial services. Narasimhan Committee I noted that the objective of Financial Sector Reforms in India should not focus on correcting the present financial weaknesses but should strive to eliminate the roots of the cause of the present challenges being faced by the Indian market economy.

The second generation reforms or the second phase commenced in the mid-1990s and laid greater emphasis on strengthening the financial system and on the introduction of structural improvements. Narasimhan Committee II was to look into the extent of the effectiveness of the implementation of reforms suggested by Narasimhan Committee I and was entrusted with the responsibility to lay down a course of future reforms for the growth and integration of the Indian banking sector with international standards.

Unit-II: Management of Commercial Banks:

Banking Industry in India: Modern **banking in India** originated in the last decade of the 18th century. Among the first banks were the Bank of Hindustan, which was established in 1770 and liquidated in 1829–32; and the General Bank of India, established in 1786 but failed in 1791.

The largest and the oldest bank which is still in existence is the State Bank of India (S.B.I). It originated and started working as the Bank of Calcutta in mid-June 1806. In 1809, it was renamed as the Bank of Bengal. This was one of the three banks founded by a presidency government, the other two were the Bank of Bombay in 1840 and the Bank of Madras in 1843. The three banks were merged in 1921 to form the Imperial Bank of India, which upon India's independence, became the State Bank of India in 1955. For many years the presidency banks had acted as quasi-central banks, as did their successors, until the Reserve Bank of India[5] was established in 1935, under the Reserve Bank of India Act, 1934.

In 1960, the State Banks of India was given control of eight state-associated banks under the State Bank of India (Subsidiary Banks) Act, 1959. These are now called its associate banks. In 1969 the Indian government nationalised 14 major private banks; one of the big banks was Bank of India. In 1980, 6 more private banks were nationalised. These nationalised banks are the majority of lenders in the Indian economy. They dominate the banking sector because of their large size and widespread networks.

The Indian banking sector is broadly classified into scheduled and non-scheduled banks. The scheduled banks are those included under the 2nd Schedule of the Reserve Bank of India Act, 1934. The scheduled banks are further classified into: nationalised banks; State Bank of India and its associates; Regional Rural Banks (RRBs); foreign banks; and other Indian private sector banks. The term commercial banks refers to both scheduled and non-scheduled commercial banks regulated under the Banking Regulation Act, 1949.

Generally the supply, product range and reach of banking in India is fairly mature-even though reach in rural India and to the poor still remains a challenge. The government has developed initiatives to address this through the State Bank of India expanding its branch network and through the National Bank for Agriculture and Rural Development (NABARD) with facilities like microfinance.

The following banks were nationalized in 1969:

- Allahabad Bank(now Indian Bank)
- Bank of Baroda
- Bank of India
- Bank of Maharashtra
- Central Bank of India
- Canara Bank
- Dena Bank (Now Bank of Baroda)
- Indian Bank
- Indian Overseas Bank
- Punjab National Bank
- Syndicate Bank(now Canara Bank)
- UCO Bank
- Union Bank of India
- United Bank of India(now Punjab National Bank)

Constituents of Banking Industry

1. Central Bank – Reserve Bank of India (RBI)
2. Commercial Banks

- Public sector Banks
- Private Banks

- Foreign Banks

3. Co-operative Banks

- Primary Credit Societies
- Central Co-operative Banks
- State Co-operative Banks

4. Regional Rural Banks
5. Development Banks
6. Specialized Banks

- Export Import Bank of India
- Small Industries Development Bank of India
- National Bank for Agricultural and Rural Development

7. Indian Bank-like financial institutions

- Microfinance institutions
- Development financial institutions

Banking Sectors Reforms:

Major Reforms in The Banking Sector

- **10 Public Sector Banks Merged into 4**

  In the bid to strengthen the role of the public sector banks in the Economy, the Government of India rolled out the third round of Bank merger plan in September. The ministry decided to merge ten public sector banks into a total of four. As per the merger, selected acquirer banks were to take over the allotted Bank(s). Punjab National Bank was decided to merge with Oriental Bank of Commerce, and the United Bank of India; Indian Bank with Allahabad Bank, Canara Bank with Syndicate Bank, and Union Bank of India with Andhra Bank and Corporation Bank.

  By merging the PSBs, the Government aimed to reduce the number of Public Sector Banks, which can help fulfill the vision of creating 3-4 global sized banks. Further, the merger could indeed help raise a large capital base for the Economy, as banks would be able to allow more loans with merged capitals. Also, this could make it easier for the authorities to monitor a limited number of banks. The merger comes into effect latest by April 2020.

- **Loan Rates came down as RBI reduced Lending Rates**

  The Reserve Bank of India is the central bank, and thus being the regulatory authority of all banks, RBI took the required steps by changing and revising its charges from time to time throughout the year. In the year 2019, the RBI cut its lending rates six times in a row, by splashing down repo rate, (the rate at which the RBI lends funds to the banks), by 135 basis points bringing it to 5.15% and reverse repo rate (rate at which the central bank borrows money from commercial banks) at 4.90%. Both repo rate and reverse repo rate are essential tools used by RBI to regulate the liquidity and credit availability in the market. A lower repo rate by RBI is an attempt to spur credit growth in the Economy.

  Further, to provide more in the Economy, in September 2019, RBI made it compulsory for Banks to link the floating interest rates on loans to RBI's repo rate or to the other external benchmarks set by RBI by October 1. The interest rates on loans were earlier affected by the MCLR. However, the repo linked interest rate as an effective benchmark is a great move to benefit the customers and to encourage more liquidity in the market, as it will bring in more transparency.

All the measures taken by RBI were set to benefit the loan borrowers as it can help customers save more on their interests.

- **Aadhaar and PAN Card Authentication Mandatory to Fill ITR**

  The authorities introduced the Aadhar Amendment Bill 2019, in June. The bill allows the Aadhaar card to be used as a valid Id Proof for opening a bank account. After this recognition, Aadhaar became a compulsory tool in any financial activity, such as to deposit large cash deposits. Later, Aadhaar linked KYC became a compulsion for existing and new account holders in banks. However, this was ruled out by the Supreme court's judgment in September 2019, which indeed made Aadhaar a necessary document to fill ITR by emphasizing on PAN cards linked to Aadhaar as the only valid PAN cards. With effect from April 1, 2020, any PAN Card not linked to Aadhaar will be considered invalid and people will not be able to file their income tax returns. The deadline for this has been extended from December 31, 2019, to March 31, 2020.

- **Banking became Easier with Digital Options**

  Digitalization is the talk of the hour, especially when it comes to factors like upgrading and ease. The Indian Banking sector experienced a great uproar in the digital services in the year 2019. Many Banks, including the popular ones like SBI, Kotak Mahindra, and Axis Bank, planned to go onboard with digital services by incorporating artificial intelligence and analytics in their banking mechanism. A majority of banks have started offering almost all of their offline services on online platforms, such as the Public Sector Banks online platform launched in August 2019, 'psbloansin59minutes', or Axis Bank's 'Express FD' platform launched in October 2019 to open an FD account online. Indeed, even public sector lenders like India Post went all-digital in the year, by providing a mobile facility for PPFs and Savings account.

  Digital moves by the banks to shift towards the cashless Economy, have uplifted the financial sector well, by providing access to easier payments. E-commerce, mobile commerce, and online payments have been successful. The upliftment of UPI (Unified Payments Interface) in the year 2019 is evident in the ease and convenience that digital payments provide users with. UPI transactions crossed around 1 billion transactions in the month of October 2019. Also, the Point of Sale Terminals rose to 3.99 million in June 2019, by 20.5% than the previous June. Thus, the year 2019 contributed well to make the Indian Economy digitalized and cashless.

- **Revised ATM Mechanisms for Safe and Secure Transactions**

  The year began with the reform in ATM transactions. With effect from January 1, 2019, ATM cards without chips were unacceptable, and the chip-based magnetic striped card was brought to effect. This changed the way the ATM cards operated. Earlier the card needed to be swiped once for verification; however, now the card remains inserted in the ATM machine until the transaction completes. This move was initiated to make ATM transactions more secure and safe.

In addition to that, various Banks like SBI, HDFC, Axis, and ICICI revised the number of free transactions to five each month that can be availed with an ATM card after RBI posted a notification in June 2019 to do the same. Charges on exceeding the number of free transactions were increased than the earlier ones and were inclusive of GST. Apart, as per the August notification by RBI, Banks were instructed to treat failed transactions (failed transactions due to technical reasons or unavailability of the fund in the ATM) not as a part of the available five free transactions. Thus, in total various ATM changes were incorporated in the year 2019.

On a concluding note, though the year 2019 witnessed a slowdown of the financial streams, yet, the Banking sector was improvised with the necessary steps as and when required. The attempted reforms brought in by the respective policymakers and authorities were brought with a vision of a better year ahead. Thus, these reforms could likely lay a foundation for an economically sound 2020.

Determination of Commercial Interest Rates: Fixed and Floating

Interest rates are the cost of borrowing money. They represent what creditors earn for lending you money. These rates are constantly changing, and differ based on the lender, as well as your creditworthiness. Interest rates not only keep the economy functioning, but they also keep people borrowing, spending, and lending. But most of us don't really stop to think about how they are implemented or who determines them.

- Interest rates are the cost of borrowing money and represent what creditors earn for lending money.
- Central banks raise or lower short-term interest rates to ensure stability and liquidity in the economy.
- Long-term interest rates are affected by demand for 10- and 30-year U.S. Treasury notes. Low demand for long-term notes leads to higher rates, while higher demand leads to lower rates.
- Retail banks also control rates based on the market, their business needs, and individual customers.
- Rates on individual loans are impacted by loan terms and credit rating.

Short-Term Interest Rates: Central Banks

In countries using a centralized banking model, short-term interest rates are determined by central banks. A government's economic observers create a policy that helps ensure stable prices and liquidity. This policy is routinely checked so the supply of money within the economy is neither too large, which causes prices to increase, nor too small, which can lead to a drop in prices.

In the U.S., interest rates are determined by the Federal Open Market Committee (FOMC), which consists of seven governors of the Federal Reserve

Board and five Federal Reserve Bank presidents. The FOMC meets eight times a year to determine the near-term direction of monetary policy and interest rates. The actions of central banks like the Fed affect short-term and variable interest rates.

If the monetary policymakers wish to decrease the money supply, they will raise the interest rate, making it more attractive to deposit funds and reduce borrowing from the central bank. Conversely, if the central bank wishes to increase the money supply, they will decrease the interest rate, which makes it more attractive to borrow and spend money.

The Fed funds rate affects the prime rate—the rate banks charge their best customers, many of whom have the highest credit rating possible. It's also the rate banks charge each other for overnight loans.

Long-Term Interest Rates: Demand for Treasury Notes

Many of these rates are independent of the Fed funds rate, and, instead, follow 10- or 30-year Treasury note yields. These yields depend on demand after the U.S. Treasury Department auctions them off on the market. Lower demand tends to result in high interest rates. But when there is a high demand for these notes, it can push rates down lower.

If you have a long-term fixed-rate mortgage, car loan, student loan, or any similar non-revolving consumer credit product, this is where it falls. Some credit card annual percentage rates are also affected by these notes.

These rates are generally lower than most revolving credit products but are higher than the prime rate.

Deposit & Loan Rates: Retail Banks

Retail banks are also partly responsible for controlling interest rates. Loans and mortgages they offer may have rates that change based on several factors including their needs, the market, and the individual consumer.

For example, someone with a lower credit score may be at a higher risk of default, so they pay a higher interest rate. The same applies to credit cards. Banks will offer different rates to different customers, and will also increase the rate if there is a missed payment, bounced payment, or for other services like balance transfers and foreign exchange.

Management of Capital Funds:

Funds management is the overseeing and handling of a financial institution's cash flow. The fund manager ensures that the maturity schedules of the deposits coincide with the demand for loans. To do this, the manager looks at both the liabilities and the assets that influence the bank's ability to issue credit.

Funds Management in Action

Funds management—also referred to as asset management—covers any kind of system that maintains the value of an entity. It may be applied to intangible assets (e.g., intellectual property and goodwill), and tangible assets (e.g., equipment and real estate). It is the systematic process of operating, deploying, maintaining, disposing, and upgrading assets in the most cost-efficient and profit-yielding way possible.

A fund manager must pay close attention to cost and risk to capitalize on the cash flow opportunities. A financial institution runs on the ability to offer credit to customers. Ensuring the proper liquidity of the funds is a crucial aspect of the fund manager's position. Funds management can also refer to the management of fund assets.

In the financial world, the term "fund management" describes people and institutions that manage investments on behalf of investors. An example would be investment managers who fix the assets of pension funds for pension investors.

Divisions of Use

Fund management may be divided into four industries:

- Financial investment industry
- Infrastructure industry
- Business and enterprise industry
- The public sector

The most common use of "fund management" refers to investment management or financial management, which are within the financial sector responsible for managing investment funds for client accounts. The fund manager's duties include studying the client's needs and financial goals, creating an investment plan, and executing the investment strategy.

Classifying Fund Management

Fund management can be classified according to client type, the method used for management, or the investment type.

When classifying fund management according to client type, the fund managers are either business fund managers, corporate fund managers, or personal fund managers who handle investment accounts for individual investors. Personal fund managers cover smaller investment portfolios compared to business fund managers. These funds may be controlled by one fund manager or by a team of many fund managers.

Some funds are managed by hedge fund managers who earn from an upfront fee and a certain percentage of the fund's performance, which serves as an incentive for them to perform to the best of their abilities.

Capital Adequacy Norms

Capital Adequacy Ratio (**CAR**) is also known as *Capital to Risk (Weighted) Assets Ratio* (**CRAR**), is the ratio of a bank's capital to its risk. National regulators track a bank's CAR to ensure that it can absorb a reasonable amount of loss and complies with statutory Capital requirements.

It is a measure of a bank's capital. It is expressed as a percentage of a bank's risk-weighted credit exposures. The enforcement of regulated levels of this ratio is intended to protect depositors and promote stability and efficiency of financial systems around the world.

Two types of capital are measured: tier one capital, which can absorb losses without a bank being required to cease trading, and tier two capital, which can absorb losses in the event of a winding-up and so provides a lesser degree of protection to depositors.

Use

Capital adequacy ratio is the ratio which determines the bank's capacity to meet the time liabilities and other risks such as credit risk, operational risk etc. In the most simple formulation, a bank's capital is the "cushion" for potential losses, and protects the bank's depositors and other lenders. Banking regulators in most countries define and monitor *CAR* to protect depositors, thereby maintaining confidence in the banking system.[1]

CAR is similar to leverage; in the most basic formulation, it is comparable to the inverse of debt-to-equity leverage formulations (although CAR uses equity over assets instead of debt-to-equity; since assets are by definition equal to debt plus equity, a transformation is required). Unlike traditional leverage, however, CAR recognizes that assets can have different levels of risk.

Liquidity Management:

Liquidity management takes one of two forms based on the definition of liquidity. One type of liquidity refers to the ability to trade an asset, such as a stock or bond, at its current price. The other definition of liquidity applies to large organizations, such as financial institutions. Banks are often evaluated on their liquidity, or their ability to meet cash and collateral obligations without incurring substantial losses. In either case, liquidity management describes the effort of investors or managers to reduce liquidity risk exposure.

Liquidity Management in Business

Investors, lenders, and managers all look to a company's financial statements using liquidity measurement ratios to evaluate liquidity risk. This is usually done by comparing liquid assets and short-term liabilities, determining if the company can make excess investments, pay out bonuses or, meet their debt obligations. Companies that are over-leveraged must take steps to reduce the gap between their cash on hand and their debt obligations. When companies are over-leveraged, their liquidity risk is much higher because they have fewer assets to move around.

Liquidity Management in Investing

Investors still use liquidity ratios to evaluate the value of a company's stocks or bonds, but they also care about a different kind of liquidity management. Those who trade assets on the stock market cannot just buy or sell any asset at any time; the buyers need a seller, and the sellers need a buyer.

Asset Liability Management:

Asset/liability management is the process of managing the use of assets and cash flows to reduce the firm's risk of loss from not paying a liability on time. Well-managed assets and liabilities increase business profits. The asset/liability management process is typically applied to bank loan portfolios and pension plans. It also involves the economic value of equity.

The concept of asset/liability management focuses on the timing of cash flows because company managers must plan for the payment of liabilities. The process must ensure that assets are available to pay debts as they come due and that assets or earnings can be converted into cash. The asset/liability management process applies to different categories of assets on the balance sheet.

Gap Analysis:

A gap analysis is a method of assessing the differences in performance between a business' information systems or software applications to determine whether business requirements are being met and, if not, what steps should be taken to ensure they are met successfully. *Gap* refers to the space between "where we are" (the present state) and "where we want to be" (the target state). A gap analysis may also be referred to as a needs analysis, needs assessment or need-gap analysis.

The first step in conducting a gap analysis is to establish specific target objectives by looking at the company's mission statement, strategic goals and improvement objectives. The next step is to analyze current business processes by collecting relevant data on performance levels and how resources are presently allocated to these processes. This data can be collected from a variety of sources depending on what's being analysed, such as by looking at documentation, conducting interviews, brainstorming and observing project activities. Lastly, after a company compares its target goals against its current state, it can then draw up a comprehensive plan that outlines specific steps to take to fill the gap between its current and future states, and reach its target objectives.

Management of Non-Performing Assets: A nonperforming asset (NPA) refers to a classification for loans or advances that are in default or in arrears. A loan is in arrears when principal or interest payments are late or missed. A loan is in default when the lender considers the loan agreement to be broken and the debtor is unable to meet his obligations.

- Nonperforming assets (NPAs) are recorded on a bank's balance sheet after a prolonged period of non-payment by the borrower.
- NPAs place financial burden on the lender; a significant number of NPAs over a period of time may indicate to regulators that the financial health of the bank is in jeopardy.
- NPAs can be classified as a substandard asset, doubtful asset, or loss asset, depending on the length of time overdue and probability of repayment.
- Lenders have options to recover their losses, including taking possession of any collateral or selling off the loan at a significant discount to a collection agency.
- Nonperforming assets are listed on the balance sheet of a bank or other financial institution. After a prolonged period of non-payment, the lender will force the borrower to liquidate any assets that were pledged as part of the debt agreement. If no assets were pledged, the lender might write-off the asset as a bad debt and then sell it at a discount to a collection agency.
- In most cases, debt is classified as nonperforming when loan payments have not been made for a period of 90 days. While 90 days is the standard, the amount of elapsed time may be shorter or longer depending on the terms and conditions of each individual loan. A loan can be classified as a nonperforming asset at any point during the term of the loan or at its maturity.
- For example, assume a company with a $10 million loan with interest-only payments of $50,000 per month fails to make a payment for three consecutive months. The lender may be required to categorize the loan as nonperforming to meet regulatory requirements. Alternatively, a loan can also be categorized as nonperforming if a company makes all interest payments but cannot repay the principal at maturity.
- Carrying nonperforming assets, also referred to as nonperforming loans, on the balance sheet places significant burden on the lender. The nonpayment of interest or principal reduces the lender's cash flow, which can disrupt budgets and decrease earnings. Loan loss provisions, which are set aside to cover potential losses, reduce the capital available to provide subsequent loans to other borrowers. Once the actual losses from defaulted loans are determined, they are written off against earnings. Carrying a significant amount of NPAs on the balance sheet

over a period of time is an indicator to regulators that the financial health of the bank is at risk.

Types of Non-Performing Assets (NPA)

Although the most common nonperforming assets are term loans, there are other forms of nonperforming assets as well.

- Overdraft and cash credit (OD/CC) accounts left out-of-order for more than 90 days
- Agricultural advances whose interest or principal installment payments remain overdue for two crop/harvest seasons for short duration crops or overdue one crop season for long duration crops
- Expected payment on any other type of account is overdue for more than 90 days

Recording Non-Performing Assets (NPA)

Banks are required to classify nonperforming assets into one of three categories according to how long the asset has been non-performing: sub-standard assets, doubtful assets, and loss assets. A sub-standard asset is an asset classified as an NPA for less than 12 months. A doubtful asset is an asset that has been non-performing for more than 12 months. Loss assets are loans with losses identified by the bank, auditor, or inspector that need to be fully written off. They typically have an extended period of non-payment, and it can be reasonably assumed that it will not be repaid.

Strategies for making Commercial Banks Viable:

The future of bank branches can be debated ad nauseum. There is no debate, however, that branches that are fiscal under-performers need to be either consolidated or closed down altogether. For a branch to survive, it must be located correctly and use all available space for transaction support, enhancing brand awareness and improving sales.

In reality, even with the rapid growth of digital banking, the brick-and-mortar branch is still alive. And while there is no single template or formula for successful branches, we're embarking on an increasingly customized path, where physical branches are being revived by adapting to locational and needs-based consumer niches.

1. Branch location and design that reflects digital channel integration
2. Expansion of branch personnel duties
3. Utilization of multi-sensory marketing communications
4. Focus on overarching efficiency

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1. Bricks + Clicks: Integrating Physical and Digital

Using powerful software and experienced researchers, financial institutions can now leverage reliable data to optimize site selection as part of their growth strategy.

Proximity analysis that identifies small business, retail and commercial zones, local competitor branch deposit flows, and demographic profiles are all indicators of a branch's potential to thrive or fail. Retailers like McDonald's and CVS pharmacies as well as almost all major restaurant chains have grown optimally due to the application of site location science for years. The banking industry lags far behind these industries. In response to the decline in branch transactions, physical footprints have been successively reduced over the decades; from as much as 10,000 square feet in the 70's, to around 3,500 square feet to 2,000 square feet at the turn of the century, to today's micro-branches that can occupy a space of less than 1,000 square feet.

The smaller the branch, the more available locations, the less expensive to buy, rent or maintain and the greater the ability to be convenient for a targeted audience. And today, convenience is king. The financial services industry is currently poised to undergo a personalization revolution to parallel the convenience of custom branches. The so-called '***Bank of Things***' (as coined by Accenture) will customize experiences by digitally connecting every consumer to all of their financial relationships, including insurance, health services, real estate investments, loans and even social media interactions.

2. Embracing the Concept of Universal Bankers

To increase the effectiveness of physical delivery channels, transaction-based tellers will have to be cross-trained to perform like retail sales associates. Engaging customers with digital tools, such as tablets, the Universal Banker will be able to access personal details to better match needs to solutions. Proficiency with these devices, plus enough expertise to offer reliable counsel, is crucial for success of a Universal Banker.

The multifaceted universal banker role includes (but is not limited to):

- Greeting and guiding customers
- Traditional deposit/withdrawal transactions
- Digital bill paying
- Financial needs assessment based on customer profile
- Relationship expansion advice and facilitation (deposits, loans, investments, insurance, etc.)
- Digital banking self-service education
- Customer relationship development

3. Building Retail Channel Diversity

The true value of smart-branches lies in their retail diversity, not technology. Today's fetishized "Fortress of Geekitude" will be tomorrow's obsolete low-tech fossil, usurped by newer machines … but the human touch and human service will never die. For the branch to remain relevant, institutions will need to offer a differentiated experience and advice on money matters the average consumer has yet to learn. With enhanced retail channels comes improved retail communications as well. Financial institutions are just beginning to embrace the possibilities for effective in-branch merchandising and the digital marketing of products and services. In person, and digitally connected, investment and lending advice, digital connections to various financial accounts and local banking workshops will become more common. And they will be increasingly marketed to information-hungry young professionals. There's currently an array of digital kiosks, flat-screen TV's, interactive walls and endless merchandising displays available to financial institutions for the purposes of shaping customer experience, with still more to come. The coordination of multiple channels within the retail branch environment will assist sales efforts.

4. Redefining Efficiency Per Square Foot

It is time to move from a cost per square foot mentality to an efficiency per square foot measurement criteria when evaluating branch locations in banking. Beyond shrinking of branch footprints, efficiency now includes developing LEED-certified projects, utilizing customer-facing audio-visual equipment and installing new cash-counting technologies that can make a branch both more efficient and effective. Retail companies spend nearly $20 billion on energy each year, according to the US Small Business Administration. Newer branches are being designed according to "green" standards, with energy systems that are more easily tracked and managed. They're also installing cash recyclers in teller pods that can dispense bills, accept cash and coin, and count thousands of dollars in notes without making a mistake. As Universal Bankers bring more value-per-employee to the branch through versatility, more basic teller transactions can be performed via remote video links on ITM's. Video call centers can be staffed by reduced numbers of transaction tellers, eliminating the 'down time' common in traditional branch formats.

With improved efficiency using significantly smaller footprints, some organizations may actually *increase* smart-branch locations in the near-term, offering an expanding array of personal banking services within each unit. Using both permanent and temporary 'pop-up' branch facilities, the potential to rethink the traditional banking branch is limitless and could breath new life into branch banking.

Unit-III: Non-Banking Financial Institutions:

N.B.F.C.: A Non-Banking Financial Company (NBFC) is a company registered under the Companies Act, 1956 engaged in the business of loans and advances, acquisition of shares/stocks/bonds/debentures/securities issued by Government or local authority or other marketable securities of a like nature, leasing, hire-purchase, insurance business, chit business but does not include any institution whose principal business is that of agriculture activity, industrial activity, purchase or sale of any goods (other than securities) or providing any services and sale/purchase/construction of immovable property. A non-banking institution which is a company and has principal business of receiving deposits under any scheme or arrangement in one lump sum or in instalments by way of contributions or in any other manner, is also a non-banking financial company (Residuary non-banking company).

A Non-Banking Financial Company (NBFC) is a company registered under the Companies Act, 2013 of India, engaged in the business of loans and advances, acquisition of shares, stock, bonds, hire-purchase insurance business or chit-fund business, but does not include any institution whose principal business is that of agriculture, industrial activity, purchase or sale of any goods (other than securities) or providing any services and sale/purchase/construction of immovable property.

The working and operations of NBFCs are regulated by the Reserve Bank of India (RBI) within the framework of the Reserve Bank of India Act, 1934 (Chapter III-B) and the directions issued by it. On November 9, 2017, Reserve Bank of India (RBI) issued a notification outlining norms for outsourcing of functions/services by Non-Bank Financial Institution (NBFCs) as per the new norms, NBFCs cannot outsource core management functions like internal audit, management of investment portfolio, strategic and compliance functions for know your customer (KYC) norms and sanction of loans. Staff of service providers should have access to customer information only up to an extent which is required to perform the outsourced function. Boards of NBFCs should approve a code of conduct for direct sales and recovery agents. For debt collection, NBFCs and their outsourced agents should not resort to intimidation or harassment of any kind. All NBFCs' have been directed to set up a grievance redressal machinery, which will also deal with the issues relating to services provided by the outsourced agency.

The most important difference between non-banking financial companies and banks is that NBFCs don't take demand deposits. A **non-banking financial institution** (**NBFI**) or **non-bank financial company** (**NBFC**) is a financial institution that does not have a full banking license or is not supervised by a national or international banking regulatory agency. NBFI facilitate bank-related financial services, such as investment, risk pooling, contractual savings, and market brokering. Examples of these include insurance firms, pawn shops, cashier's check issuers, check cashing locations, payday lending, currency exchanges, and microloan organizations. Alan Greenspan has identified the role of NBFIs in strengthening an economy, as they provide "multiple alternatives to transform an economy's savings into capital investment which act as backup facilities should the primary form of intermediation fail.

Types of NBFCs in India

Investment and Credit Company (ICC)

Merging three categories of NBFCs viz asset finance companies (AFC), Loan companies (LC), Investment companies (IC) into a new category called NBFC - ICC.

ICC means any company which is a financial institution carrying on as its principal business asset financing, the providing of finance whether by making loan and advances or otherwise forany activity other than its own and the acquisition of securities ; and is not any other category of NBFC as defined by RBI in any of its master directions.

Infrastructure Finance Company (IFC)

Infrastructure finance companies deploys a minimum of three-fourths of their total assets in infrastructure loans. The net owned funds are more than 3 billion and a minimum crediting rating of 'A' and the Capital to Risk-Weighted Assets Ratio is 15%.

Infrastructure Debt Fund: Non- Banking Financial Company (IDF-NBFC)

IDF-NBFC is a company registered as NBFC to facilitate the flow of long term debt into infrastructure projects. IDF-NBFC raise resources through Multiple-Currency bonds of minimum 5-year maturity. Only Infrastructure Finance Companies (IFC) can sponsor IDF-NBFCs.

NBFC-Factors

NBFC Factors has principle business of factoring. Factoring is a financial transaction and a type of debtor finance

Gold Loan NBFCs in India

Over the years, gold loan NBFCs witnessed an upsurge in Indian financial market, owing mainly to the recent period of appreciation in gold price and consequent increase in the demand for gold loan by all sections of society, especially the poor and middle class to make ends meet. Though there are many NBFCs offering gold loans in India, about 95 per cent of the gold loan business is handled by three Kerala based companies, viz., Muthoot Finance, Manapuram Finance and Muthoot Fincorp. Growth of gold loan NBFCs eventuating from various factors including Asset Under Management (AUM), number of branches, and also the number of customers etc. Growth of gold loan NBFCs occurred both in terms of the size of their balance sheet and their physical presence that compelled to increase their dependence on public funds including bank finance and non-convertible debentures. Aggressive structuring of gold loans resulting from the uncomplicated, undemanding and fast process of documentation along with the higher Loan to Value (LTV) ratio include some of the major factors that augment the growth of Gold loan NBFCs.[3]

Residuary Non-Banking Companies (RNBCs)

Residuary Non-Banking Company is a class of NBFC which is a company and has as its principal business the receiving of deposits, under any scheme or arrangement or in any other manner and not being Investment, Asset Financing, Loan Company. These companies are required to maintain investments as per directions of RBI, in addition to liquid assets.

Account Aggregators (AA)

Account Aggregators are a new class of NBFC instituted by the Reserve Bank of India in 2016.[4] An account aggregator NBFC takes the business of account aggregation for a fee or otherwise. The NBFC once registered with the RBI, should only provide account aggregation and data to financial institutions based on customer consent. The actual mechanism should follow the consent architecture laid down by the RBI.[4]

The account aggregators are expected to make loan application easier for users by providing data access to financial institutions.[5] RBI has given in-principle approvals to five NBFC Account Aggregators.

Role in financial system

NBFIs supplement banks by providing the infrastructure to allocate surplus resources to individuals and companies with deficits. Additionally, NBFIs also introduces competition in the provision of financial services. While banks may offer a set of financial services as a packaged deal, NBFIs unbundle and tailor these service to meet the needs of specific clients. Additionally, individual NBFIs may specialize in one particular sector and develop an informational advantage. Through the process of unbundling, targeting, and specializing, NBFIs enhances competition within the financial services industry.

Non-bank financial companies (NBFCs) offer most sorts of banking services, such as loans and credit facilities, private education funding, retirement planning, trading in money markets, underwriting stocks and shares, TFCs(Term Finance Certificate) and other obligations. These institutions also provide wealth management such as managing portfolios of stocks and shares, discounting services e.g. discounting of instruments and advice on merger and acquisition activities. The number of non-banking financial companies has expanded greatly in the last several years as venture capital companies, retail and industrial companies have entered the lending business. Non-bank institutions also frequently support investments in property and prepare feasibility, market or industry studies for companies. However they are typically not allowed to take deposits from the general public and have to find other means of funding their operations such as issuing debt instruments.

NBFCs are not providing the cheque book nor saving account and current account. It only takes fixed deposit or time deposits.

Growth

Some research suggests a high correlation between a financial development and economic growth. Generally, a market-based financial system has better-developed NBFIs than a bank-based system, which is conducive for economic growth. Linkages between bankers and brokers.

Stability

A multi-faceted financial system that includes non-bank financial institutions can protect economies from financial shocks and enable speedy recovery when these shocks happen. NBFIs provide “multiple alternatives to transform an economy's savings into capital investment, [which] serve as backup facilities should the primary form of intermediation fail.”[9]

However, in the absence of effective financial regulations, non-bank financial institutions can actually exacerbate the fragility of the financial system.

Since not all NBFIs are heavily regulated, the shadow banking system constituted by these institutions could wreak potential instability. In particular, CIVs, hedge funds, and structured investment vehicles, up until the financial crisis of 2007–2008, were entities that focused NBFI supervision on pension funds and insurance companies, but were largely overlooked by regulators.

Because these NBFIs operate without a banking license, in some countries their activities are largely unsupervised, both by government regulators and credit reporting agencies. Thus, a large NBFI market share of total financial assets can easily destabilize the entire financial system. A prime example would be the 1997 Asian financial crisis, where a lack of NBFI regulation fueled a credit bubble and asset overheating. When the asset prices collapsed and loan defaults skyrocketed, the resulting credit crunch led to the 1997 Asian financial crisis that left most of Southeast Asia and Japan with devalued currencies and a rise in private debt.

Due to increased competition, established lenders are often reluctant to include NBFIs into existing credit-information sharing arrangements. Additionally, NBFIs often lack the technological capabilities necessary to participate in information sharing networks. In general, NBFIs also contribute less information to credit-reporting agencies than do banks.

For continual growth and sustenance of NBFCs, it is important to have a regulation around them while maintaining their innovativeness. An introduction of regulatory sandbox in different ecosystem will help them achieve the desired results. Many countries have adopted Regulatory Sandbox and soon more will adopt.

Strategies for Commercial Viability: Non-Banking Financial Company also known as NBFC company, functioning as per the Indian Companies Act, giving loans and advances to the public. An NBFC company can acquire shares, stocks, bonds, debentures and securities from Government as well as local authority or any other marketable securities. Marketing securities are considered to be leasing, hire purchase, insurance brokerage, chit fund etc. An NBFC Company mainly accepts deposits in various schemes -it may be a lump-sum amount or multiple installments in order to roll their business active.

Though NBFC company lend and make investments with public just like what a commercial banks do, there are some apparent restrictions to them issued by RBI mainly as given below:

1. NBFC company should keep away from accepting demand deposits from any sources.

2. NBFC company can't issue cheques drawn on itself.

3. NBFC Company can't form part of the payment and settlement system.

4. Depositors of a NBFC company cannot have facilities like deposit insurance scheme.

Insurance and Mutual Fund Organisations:

Insurance Organisations: Insurance is a means to manage a contingent loss through which responsibility for a risk is transferred to another party in exchange for payment before the loss. The cost of insurance is based upon the insurance company's pooling of similar risks, occurrences that can be estimated using statistical modelling (actuarial analysis). An insurance company earns revenue from premiums, as well as the investment of those premiums in various financial instruments/markets. Insurance can be purchased by individuals for life, health, property and liability losses. Corporations purchase insurance to cover liability, property, business and executive health and life risks. Insurance can be purchased directly from a company, through "captive" agents working for a single firm or through independent insurance agents who sell products from multiple insurance providers.

Insurance companies operate under one of two business structures. These structures have their own unique features, advantages and disadvantages. The structure of the company also drives the long-term business activity and how the company operates. It may affect the investments it makes and even the types of policies it designs and sells.

Mutual Structure

A mutual insurance company is an insurance company that is not publicly traded. The company is effectively owned by the policyholders. Because of this, the interests of the management are aligned with those of the policyholders in a direct way. The management is incentivized to work for the long-term benefit of the policyholders, since actions that work against the policyholders may cause them to leave the company. Mutual insurers generally have only one way to make money. They must sell new policies. The exception to this is life insurers, which may also raise funds through interest on policy loans.

Stock Structure

A stock insurance company is publicly traded. The company is not necessarily disincentivized to work for the long-term best interest of the policyholders. However, the insurer has to balance the interests of the policyholders with that of outside stockholders. These stockholders may or may not own policies issued by the company. A stock company may raise money by selling policies or issuing more stock of the company. In the case of life insurance companies, stock insurers may encourage policyholders to take policy loans and collect interest payments.

Types and Role of Insurance Organisation:

Health Insurance

The Health Insurance line of business offers health plan benefits to customers. While there are several insurers that focus exclusively on health insurance, many multi-line insurers also offer health coverage. Health insurance can be provided on an individual or group (company or family coverage) basis and provides coverage for medicine, visits to the doctor or emergency room, hospital stays and other medical expenses. Health insurance is often included in employer benefit packages as a means of attracting quality employees.

Investment Management

The Investment Management line of business offers traditional retail investment products to customers. Investment products and services typically offered by insurance firms include annuities, universal life insurance, retirement planning and investment and college savings plans. Some insurance companies may offer investment solutions for businesses.

Life

The Life Insurance Group provides policyholders protection against the loss of income that would result if the insured passed away. The named beneficiary or beneficiaries then receive the proceeds and are thereby safeguarded from the financial impact of the death of the insured. Depending on the contract, some events such as terminal illness can trigger payment to the beneficiaries, while other events such as claims relating to suicide, or fraud are written as exclusions so as to limit the liability of the insurer. Life-based insurance contracts tend to fall into two major categories: protection policies and investment policies.

Property & Casualty

The Property & Casualty (P&C) Group provides coverage that protects against property losses such as to a home, car or other property, while also providing liability coverage to help protect policyholders if found liable for an accident that causes injuries to another person or damage to another person's belongings. P&C insurance can also cover the medical expenses of individuals involved in accidents as well as restitution or repair of damaged property. P&C insurance policies can cover several property types - aviation insurance, boiler and machinery insurance, marine insurance, earthquake insurance, renters insurance, etc.

Reinsurance

The Reinsurance Group (usually called a reinsurer) takes on all or part of the risk covered under a policy issued by another insurance company (usually called a cedent) in exchange for a percentage of the premium payment. This allows cedent companies to reduce the likelihood of having to pay a large amount of money should one or more policyholders file claims that would financially destabilize the company (this usually occurs after a major disaster such as a hurricane or earthquake). The reinsurer may be either a company specializing in reinsurance, or another insurance company.

Risk Management

The Insurance Risk Management function researches and analyzes potential liabilities for insurance policies based on potential hazards and risks. Such risks can originate from the policyholders themselves (how likely the policyholder will pay the premium and/or cause a claim to be filed), the location of the policyholder (how likely a flood will occur in an area, for instance), how lucrative an investment is (how likely the investment will incur a financial loss for the company) and so on. Based on the information gathered, companies can either accept or attempt to mitigate the risk.

Strategies for Commercial Viability of Insurance Organisation

We're all aware that we live in a digitally driven society. And for insurers, that means dealing with a new breed of customers and brokers. Today, your constituents have little to no tolerance for conventional practices.

Unfortunately, sales and service channels haven't kept pace. In fact, only 7% of insurance services are available online. In order for insurance companies to increase the volume of premiums and increase revenue, they have to meet ever-evolving digital demands.
Without the right multi-channel and multi-device service and support channels in place, insurers risk alienating constituents and losing business opportunities. In fact, 50% of your customers could be lost over the next 5 years if you fail to digitize.

Enabling stronger digital experiences is an essential component to meeting service and support expectations. And while price is perceived to be a key factor in customer retention, organizations are finding that loyalty stems out of the level of convenience offered. In fact, people are willing to pay more for better service. But it starts by identifying ways to provide digital solutions to enhance customer service.
And there are two sides to customer service: enabling customers to be served and empowering your team to better serve. You need to manage both sets of expectations and offer the right digital experiences that help achieve the needs of both 'customers.' For inspiration, take a look at these examples showcasing how some of your peers solved these business issues.

Creating a digital experience that simplifies customer service processes:

A leading UK insurance group uses a new portal that allows customers to independently change their policy details and requires the broker who wrote the policy to approve the changes before they are executed. If the changes are approved, an automated check determines if there is an adjustment needed to the policy premium; if yes, it will retrieve the policy and edit details. The portal will then send new documentation to the insured.

Creating a digital experience that reduces underwriting turnaround time:

Arch Re Facultative utilizes a custom Program Portal, which allows the team to configure new reinsurance programs based on their clients' unique characteristics and pricing structures. Now, once a program has been created, the respective underwriters and their managers have access to an array of functions through the portal, giving them a one-stop shop for management and processing.

Like I mentioned before, identifying the right portals is the first step. Delivering these solutions expeditiously and cost-effectively, however, is what will set you apart from your peers. It's time to find a faster path forward.

Transforming your ideas into applications:

To cement your position in the industry and attract new and retain existing customers, those innovative ideas that never come to fruition need to be executed and unveiled as soon as possible. Insurers need to rapidly develop new customer service and support portals to effectively engage their customers and retain customers.

But you'll need a host of new applications that speak to a myriad of digital experience demands. The following five steps will help you understand the extent of your portal deficit, organize resources across the business, and test a new approach centered around rapid application development. Rapid application development can accelerate your portal development and is praised by a number of insurers because users across business and technical roles are able to collaborate throughout the development process.

1. **Assess your needs:** It's likely that you already have a list of new portals that you'd like to deploy, but take a step back to understand the greater need across your organization.
2. **Look for quick wins**: Identify processes or interaction points that will offer the greatest return by digitizing first.
3. **Create a fast lane:** Recognize the differences between your business-led projects and other existing development projects and strike a balance between managing both models.
4. **Think minimum viable product (MVP):** Identify the essential components you wish to test and address any other components based on the order of their priority to the strategic project goal.
5. **Consider re-usability:** Consider a third-party partner in modern development platforms that provides rapid application development.

Mutual Fund Organisations:

A **mutual fund** is an open-end professionally managed investment fund that pools money from many investors to purchase securities. These investors may be retail or institutional in nature. The term is typically used in the United States, while similar structures across the globe include the SICAV in Europe (investment company with variable capital) and open-ended investment company (OEIC) in the UK.

Mutual funds have advantages and disadvantages compared to direct investing in individual securities. Advantages of mutual funds include economies of scale economies of scope, diversification, liquidity, and professional management. However, these come with mutual fund fees and expenses.

Not all investment funds are mutual funds, alternative structures include unit investment trusts, closed-end funds, and exchange-traded funds (ETFs). These alternative structures share similarities such as liquidity due to trading on exchanges and, in the United States, similar consumer protections under the Investment Company Act of 1940.

Mutual funds are also classified by their principal investments as money market funds, bond or fixed income funds, stock or equity funds, hybrid funds, or other. Funds may also be categorized as index funds, which are passively managed funds that match the performance of an index, or actively managed funds. Hedge funds are not mutual funds as hedge funds cannot be sold to the general public and lack various standard investor protections.

Types of Mutual Funds

Money market funds

Money market funds invest in money market instruments, which are fixed income securities with a very short time to maturity and high credit quality. Investors often use money market funds as a substitute for bank savings accounts, though money market funds are not insured by the government, unlike bank savings accounts.

In the United States, money market funds sold to retail investors and those investing in government securities may maintain a stable net asset value of $1 per share, when they comply with certain conditions. Money market funds sold to institutional investors that invest in non-government securities must compute a net asset value based on the value of the securities held in the funds.

In the United States, at the end of 2018, assets in money market funds were $3.0 trillion, representing 14% of the industry.

Bond funds

Bond funds invest in fixed income or debt securities. Bond funds can be sub-classified according to:

- The specific types of bonds owned (such as high-yield or junk bonds, investment-grade corporate bonds, government bonds or municipal bonds)
- The maturity of the bonds held (i.e., short-, intermediate- or long-term)
- The country of issuance of the bonds (such as the U.S., emerging market or global)
- The tax treatment of the interest received (taxable or tax-exempt)

In the United States, at the end of 2018, assets in bond funds (of all types) were $4.7 trillion, representing 22% of the industry.

Stock funds

Stock or equity funds invest in common stocks. Stock funds may focus on a particular area of the stock market, such as

- Stocks from only a certain industry
- Stocks from a specified country or region
- Stocks of companies experiencing strong *growth*
- Stocks that the portfolio managers deem to be a good *value* relative to the value of the company's business
- Stocks paying high dividends that provide *income*
- Stocks within a certain market capitalization range

In the United States, at the end of 2018, assets in stock funds (of all types) were $11.9 trillion, representing 56% of the industry.

Funds which invest in a relatively small number of stocks such as fewer than 50 are known as "focus funds"; these funds may also be activist investors and alternative investments.

Hybrid funds

Hybrid funds invest in both bonds and stocks or in convertible securities. Balanced funds, asset allocation funds, target date or target-risk funds, and lifecycle or lifestyle funds are all types of hybrid funds.

Hybrid funds may be structured as funds of funds, meaning that they invest by buying shares in other mutual funds that invest in securities. Many funds of funds invest in affiliated funds (meaning mutual funds managed by the same fund sponsor), although some invest in unaffiliated funds (i.e., managed by other fund sponsors) or some combination of the two.

In the United States, at the end of 2018, assets in hybrid funds were $1.4 trillion, representing 7% of the industry.

Equity Funds

The largest category is that of equity or stock funds. As the name implies, this sort of fund invests principally in stocks. Within this group are various subcategories. Some equity funds are named for the size of the companies they invest in: small-, mid-, or large-cap. Others are named by their investment approach: aggressive growth, income-oriented, value, and others. Equity funds are also categorized by whether they invest in domestic (U.S.) stocks or foreign equities. There are so many different types of equity funds because there are many different types of equities. A great way to understand the universe of equity funds is to use a style box, an example of which is below.

Fixed-Income Funds

Another big group is the fixed income category. A fixed-income mutual fund focuses on investments that pay a set rate of return, such as government bonds, corporate bonds, or other debt instruments. The idea is that the fund portfolio generates interest income, which it then passes on to the shareholders.

Sometimes referred to as bond funds, these funds are often actively managed and seek to buy relatively undervalued bonds in order to sell them at a profit. These mutual funds are likely to pay higher returns than certificates of deposit and money market investments, but bond funds aren't without risk. Because there are many different types of bonds, bond funds can vary dramatically depending on where they invest. For example, a fund specializing in high-yield junk bonds is much riskier than a fund that invests in government securities. Furthermore, nearly all bond funds are subject to interest rate risk, which means that if rates go up, the value of the fund goes down.

Index Funds

Another group, which has become extremely popular in the last few years, falls under the moniker "index funds." Their investment strategy is based on the belief that it is very hard, and often expensive, to try to beat the market consistently. So, the index fund manager buys stocks that correspond with a major market index such as the S&P 500 or the Dow Jones Industrial Average (DJIA). This strategy requires less research from analysts and advisors, so there are fewer expenses to eat up returns before they are passed on to shareholders. These funds are often designed with cost-sensitive investors in mind.

Balanced Funds

Balanced funds invest in a hybrid of asset classes, whether stocks, bonds, money market instruments, or alternative investments. The objective is to reduce the risk of exposure across asset classes.This kind of fund is also known as an asset allocation fund. There are two variations of such funds designed to cater to the investors objectives.

Some funds are defined with a specific allocation strategy that is fixed, so the investor can have a predictable exposure to various asset classes. Other funds follow a strategy for dynamic allocation percentages to meet various investor objectives. This may include responding to market conditions, business cycle changes, or the changing phases of the investor's own life.

Money Market Funds

The money market consists of safe (risk-free), short-term debt instruments, mostly government Treasury bills. This is a safe place to park your money. You won't get substantial returns, but you won't have to worry about losing your principal. A typical return is a little more than the amount you would earn in a regular checking or savings account and a little less than the average certificate of deposit (CD). While money market funds invest in ultra-safe assets, during the 2008 financial crisis, some money market funds did experience losses after the share price of these funds, typically pegged at $1, fell below that level and broke the buck.

Income Funds

Income funds are named for their purpose: to provide current income on a steady basis. These funds invest primarily in government and high-quality corporate debt, holding these bonds until maturity in order to provide interest streams. While fund holdings may appreciate in value, the primary objective of these funds is to provide steady cash flow to investors. As such, the audience for these funds consists of conservative investors and retirees. Because they produce regular income, tax-conscious investors may want to avoid these funds.

International/Global Funds

An international fund (or foreign fund) invests only in assets located outside your home country. Global funds, meanwhile, can invest anywhere around the world, including within your home country. It's tough to classify these funds as either riskier or safer than domestic investments, but they have tended to be more volatile and have unique country and political risks. On the flip side, they can, as part of a well-balanced portfolio, actually reduce risk by increasing diversification, since the returns in foreign countries may be uncorrelated with returns at home. Although the world's economies are becoming more interrelated, it is still likely that another economy somewhere is outperforming the economy of your home country.

Specialty Funds

This classification of mutual funds is more of an all-encompassing category that consists of funds that have proved to be popular but don't necessarily belong to the more rigid categories we've described so far. These types of mutual funds forgo broad diversification to concentrate on a certain segment of the economy or a targeted strategy. Sector funds are targeted strategy funds aimed at specific sectors of the economy, such as financial, technology, health, and so on. Sector funds can, therefore, be extremely volatile since the stocks in a given sector tend to be highly correlated with each other. There is a greater possibility for large gains, but a sector may also collapse (for example, the financial sector in 2008 and 2009).

Regional funds make it easier to focus on a specific geographic area of the world. This can mean focusing on a broader region (say Latin America) or an individual country (for example, only Brazil). An advantage of these funds is that they make it easier to buy stock in foreign countries, which can otherwise be difficult and expensive. Just like for sector funds, you have to accept the high risk of loss, which occurs if the region goes into a bad recession.

Socially-responsible funds (or ethical funds) invest only in companies that meet the criteria of certain guidelines or beliefs. For example, some socially-responsible funds do not invest in "sin" industries such as tobacco, alcoholic beverages, weapons, or nuclear power. The idea is to get competitive performance while still maintaining a healthy conscience. Other such funds invest primarily in green technology, such as solar and wind power or recycling.

Exchange Traded Funds (ETFs)

A twist on the mutual fund is the exchange traded fund (ETF). These ever more popular investment vehicles pool investments and employ strategies consistent with mutual funds, but they are structured as investment trusts that are traded on stock exchanges and have the added benefits of the features of stocks. For example, ETFs can be bought and sold at any point throughout the trading day. ETFs can also be sold short or purchased on margin. ETFs also typically carry lower fees than the equivalent mutual fund. Many ETFs also benefit from active options markets, where investors can hedge or leverage their positions. ETFs also enjoy tax advantages from mutual funds. The popularity of ETFs speaks to their versatility and convenience.

Other funds

Funds may invest in commodities or other investments.

Working of Mutual Fund Organisations:

A mutual fund scheme, as many of you may have learnt, pools money from multiple investors and invests the collected corpus in shares of listed companies, government bonds, corporate bonds, short-term money-market instruments, other securities or assets, or a combination of these investments.

The type of securities selected for the portfolio is in accordance with the investment objectives as disclosed in offer document. Therefore, an equity mutual fund scheme will invest predominantly in a portfolio of stocks, while a debt fund will invest a significant portion of its assets in bonds. Within the asset class itself, the investment objective can be further narrowed down.

Thus, within the broader equity mutual fund category, there can be Large-cap Funds, Mid-cap Funds, etc., that are focussed on a specific market capitalisation of stocks. Based on the investment style, there can be Value Funds or Focussed Equity Funds as well.

A fund manager manages the investments in a mutual fund. There can be more than one fund manager, based on the discretion of the AMC. The fund manager/s manages the fund on a day-to-day basis, deciding when to buy and sell investments according to the investment objectives of the fund.

The mutual fund collects money from you and other investors and allots units. This is similar to buying shares of a company. Under mutual funds, the price of each fund unit is known as the Net Asset Value. The assets are invested in a set of stocks or bonds that form the portfolio of the fund. The fund manager, depending on the investment objective of the scheme, decides the portfolio allocation.

Securitization:

Securitization is the financial practice of pooling various types of contractual debt such as residential mortgages, commercial mortgages, auto loans or credit card debt obligations (or other non-debt assets which generate receivables) and selling their related cash flows to third party investors as securities, which may be described as bonds, pass-through securities, or collateralized debt obligations (CDOs). Investors are repaid from the principal and interest cash flows collected from the underlying debt and redistributed through the capital structure of the new financing. Securities backed by mortgage receivables are called mortgage-backed securities (MBS), while those backed by other types of receivables are asset-backed securities (ABS).

The granularity of pools of securitized assets can mitigate the credit risk of individual borrowers. Unlike general corporate debt, the credit quality of securitized debt is non-stationary due to changes in volatility that are time- and structure-dependent. If the transaction is properly structured and the pool performs as expected, the credit risk of all tranches of structured debt improves; if improperly structured, the affected tranches may experience dramatic credit deterioration and loss.

Securitization has evolved from its beginnings in the late 18th century to an estimated outstanding of $10.24 trillion in the United States and $2.25 trillion in Europe as of the 2nd quarter of 2008. In 2007, ABS issuance amounted to $3.455 trillion in the US and $652 billion in Europe. WBS (Whole Business Securitization) arrangements first appeared in the United Kingdom in the 1990s, and became common in various Commonwealth legal systems where senior creditors of an insolvent business effectively gain the right to control the company.

Nature of Securitization

Pooling and transfer

The **originator** initially owns the assets engaged in the deal. This is typically a company looking to either raise capital, restructure debt or otherwise adjust its finances (but also includes businesses established specifically to generate marketable debt (consumer or otherwise) for the purpose of subsequent securitization). Under traditional corporate finance concepts, such a company would have three options to raise new capital: a loan, bond issue, or issuance of stock. However, stock offerings dilute the ownership and control of the company, while loan or bond financing is often prohibitively expensive due to the credit rating of the company and the associated rise in interest rates.

The consistently revenue-generating part of the company may have a much higher credit rating than the company as a whole. For instance, a leasing company may have provided $10m nominal value of leases, and it will receive a cash flow over the next five years from these. It cannot demand early repayment on the leases and so cannot get its money back early if required. If it could sell the rights to the cash flows from the leases to someone else, it could transform that income stream into a lump sum today (in effect, receiving today the present value of a future cash flow). Where the originator is a bank or other organization that must meet capital adequacy requirements, the structure is usually more complex because a separate company is set up to buy the assets.

Issuance

To be able to buy the assets from the originator, the issuer SPV issues tradable securities to fund the purchase. Investors purchase the securities, either through a private offering (targeting institutional investors) or on the open market. The performance of the securities is then directly linked to the performance of the assets. Credit rating agencies rate the securities which are issued to provide an external perspective on the liabilities being created and help the investor make a more informed decision.

In transactions with static assets, a **depositor** will assemble the underlying collateral, help structure the securities and work with the financial markets to sell the securities to investors. The depositor has taken on added significance under Regulation AB. The depositor typically owns 100% of the beneficial interest in the issuing entity and is usually the parent or a wholly owned subsidiary of the parent which initiates the transaction. In transactions with managed (traded) assets, **asset managers** assemble the underlying collateral, help structure the securities and work with the financial markets in order to sell the securities to investors.

Credit enhancement and tranching

Unlike conventional corporate bonds which are unsecured, securities created in a securitization are "credit enhanced", meaning their credit quality is increased above that of the originator's unsecured debt or underlying asset pool. This increases the likelihood that the investors will receive the cash flows to which they are entitled, and thus enables the securities to have a higher credit rating than the originator. Some securitizations use external credit enhancement provided by third parties, such as surety bonds and parental guarantees (although this may introduce a conflict of interest).

The issued securities are often split into **tranches**, or categorized into varying degrees of subordination. Each tranche has a different level of credit protection or risk exposure: there is generally a senior ("A") class of securities and one or more junior subordinated ("B", "C", etc.) classes that function as protective layers for the "A" class. The senior classes have first claim on the cash that the SPV receives, and the more junior classes only start receiving repayment after the more senior classes have been repaid. Because of the cascading effect between classes, this arrangement is often referred to as a **cash flow waterfall**. If the underlying asset pool becomes insufficient to make payments on the securities (e.g. when loans default within a portfolio of loan claims), the loss is absorbed first by the subordinated tranches, and the upper-level tranches remain unaffected until the losses exceed the entire amount of the subordinated tranches. The senior securities might be AAA or AA rated, signifying a lower risk, while the lower-credit quality subordinated classes receive a lower credit rating, signifying a higher risk.

Scope of Securitization:

Servicing

A **servicer** collects payments and monitors the assets that are the crux of the structured financial deal. The servicer can often be the originator, because the servicer needs very similar expertise to the originator and would want to ensure that loan repayments are paid to the Special Purpose Vehicle.

The servicer can significantly affect the cash flows to the investors because it controls the collection policy, which influences the proceeds collected, the charge-offs and the recoveries on the loans. Any income remaining after payments and expenses is usually accumulated to some extent in a reserve or spread account, and any further excess is returned to the seller. Bond rating agencies publish ratings of asset-backed securities based on the performance of the collateral pool, the credit enhancements and the probability of default.

When the issuer is structured as a trust, the **trustee** is a vital part of the deal as the gate-keeper of the assets that are being held in the issuer. Even though the trustee is part of the SPV, which is typically wholly owned by the Originator, the trustee has a fiduciary duty to protect the assets and those who own the assets, typically the investors.

Repayment structures

Unlike corporate bonds, most securitizations are amortized, meaning that the principal amount borrowed is paid back gradually over the specified term of the loan, rather than in one lump sum at the maturity of the loan. Fully amortizing securitizations are generally collateralised by fully amortizing assets, such as home equity loans, auto loans, and student loans. Prepayment uncertainty is an important concern with fully amortizing ABS. The possible rate of prepayment varies widely with the type of underlying asset pool, so many prepayment models have been developed to try to define common prepayment activity. The PSA prepayment model is a well-known example.

A controlled amortization structure can give investors a more predictable repayment schedule, even though the underlying assets may be non-amortising. After a predetermined "revolving period", during which only interest payments are made, these securitizations attempt to return principal to investors in a series of defined periodic payments, usually within a year. An early amortization event is the risk of the debt being retired early.

On the other hand, **bullet** or **slug** structures return the principal to investors in a single payment. The most common bullet structure is called the **soft bullet**, meaning that the final bullet payment is not guaranteed to be paid on the scheduled maturity date; however, the majority of these securitizations are paid on time. The second type of bullet structure is the **hard bullet**, which guarantees that the principal will be paid on the scheduled maturity date. Hard bullet structures are less common for two reasons: investors are comfortable with soft bullet structures, and they are reluctant to accept the lower yields of hard bullet securities in exchange for a guarantee.[6]

Securitizations are often structured as a sequential pay bond, paid off in a sequential manner based on maturity. This means that the first tranche, which may have a one-year average life, will receive all principal payments until it is retired; then the second tranche begins to receive principal, and so forth. Pro rata bond structures pay each tranche a proportionate share of principal throughout the life of the security.

Structural risks and Mis-incentives:

Some originators (e.g. of mortgages) have prioritised loan volume over credit quality, disregarding the long-term risk of the assets they have created in their enthusiasm to profit from the fees associated with origination and securitization. Other originators, aware of the reputational harm and added expense if risky loans are subject to repurchase requests or improperly originated loans lead to litigation, have paid more attention to credit quality.

Reduces funding costs: Through securitization, a company rated BB but with AAA worthy cash flow would be able to borrow at possibly AAA rates. This is the number one reason to securitize a cash flow and can have tremendous impacts on borrowing costs. The difference between BB debt and AAA debt can be multiple hundreds of basis points. For example, Moody's downgraded Ford Motor Credit's rating in January 2002, but senior automobile backed securities, issued by Ford Motor Credit in January 2002 and April 2002, continue to be rated AAA because of the strength of the underlying collateral and other credit enhancements.

Reduces asset-liability mismatch: "Depending on the structure chosen, securitization can offer perfect matched funding by eliminating funding exposure in terms of both duration and pricing basis. Essentially, in most banks and finance companies, the liability book or the funding is from borrowings. This often comes at a high cost. Securitization allows such banks and finance companies to create a self-funded asset book.

Lower capital requirements: Some firms, due to legal, regulatory, or other reasons, have a limit or range that their leverage is allowed to be. By securitizing some of their assets, which qualifies as a sale for accounting purposes, these firms will be able to remove assets from their balance sheets while maintaining the "earning power" of the assets.

Locking in profits: For a given block of business, the total profits have not yet emerged and thus remain uncertain. Once the block has been securitized, the level of profits has now been locked in for that company, thus the risk of profit not emerging, or the benefit of super-profits, has now been passed on.

Transfer risks (credit, liquidity, prepayment, reinvestment, asset concentration): Securitization makes it possible to transfer risks from an entity that does not want to bear it, to one that does. Two good examples of this are catastrophe bonds and Entertainment Securitizations. Similarly, by securitizing a block of business (thereby locking in a degree of profits), the company has effectively freed up its balance to go out and write more profitable business.

Off balance sheet: Derivatives of many types have in the past been referred to as "off-balance-sheet". This term implies that the use of derivatives has no balance sheet impact. While there are differences among the various accounting standards internationally, there is a general trend towards the requirement to record derivatives at fair value on the balance sheet. There is also a generally accepted principle that, where derivatives are being used as a hedge against underlying assets or liabilities, accounting adjustments are required to ensure that the gain/loss on the hedged instrument is recognized in the income statement on a similar basis as the underlying assets and liabilities. Certain credit derivatives products, particularly Credit Default Swaps, now have more or less universally accepted market standard documentation. In the case of Credit Default Swaps, this documentation has been formulated by the International Swaps and Derivatives Association (ISDA) who have for a long time provided documentation on how to treat such derivatives on balance sheets.

Earnings: Securitization makes it possible to record an earnings bounce without any real addition to the firm. When a securitization takes place, there often is a "true sale" that takes place between the Originator (the parent company) and the SPE. This sale has to be for the market value of the underlying assets for the "true sale" to stick and thus this sale is reflected on the parent company's balance sheet, which will boost earnings for that quarter by the amount of the sale. While not illegal in any respect, this does distort the true earnings of the parent company.

Admissibility: Future cashflows may not get full credit in a company's accounts (life insurance companies, for example, may not always get full credit for future surpluses in their regulatory balance sheet), and a securitization effectively turns an admissible future surplus flow into an admissible immediate cash asset.

Liquidity: Future cashflows may simply be balance sheet items which currently are not available for spending, whereas once the book has been securitized, the cash would be available for immediate spending or investment. This also creates a reinvestment book which may well be at better rates.

Implications of Securitization:

The size and speed of interest rate pass-through tend to increase with securitization. Liquidity, capital relief and funding from securitization help to make lending rates more responsive. Increases in pass-through with securitization are less in the consumer credit and business loan markets after the recent financial crisis relative to before the crisis. In contrast, mortgage markets tend to have larger pass-through after the financial crisis. Differences in rate transmission after the recent financial crisis point to the role on nonbanks in consumer credit and business loans and asset purchase programs of the Federal Reserve in mortgage markets. Securitization tends to make the adjustment process more efficient, and gains in efficiency from securitization are larger after the financial crisis.

A key contribution of the study differentiates securitization across markets and types to determine the effects on the interest rate pass-through process. The results show that increases in the efficiency of the adjustment process from securitization tend to be greater in mortgage markets and for all private-label securitized assets. These findings have implications for proposed government-sponsored entity (GSE) reform to reduce the role of GSEs in the housing market, promote private-label mortgage credit and strengthen securitization deals.

Securitization of Auto Loans and Housing Loans:

Securitization of Auto Loans:

An asset-backed security (ABS) is an investment security—a bond or note—which is collateralized by a pool of assets, such as loans, leases, credit card debt, royalties, or receivables. An ABS is similar to a mortgage-backed security, except that the underlying securities are not mortgage-based. For investors, asset-backed securities can be an alternative to corporate debt.

Asset-backed securities allow issuers to generate cash, which can be used for more lending, while giving investors in the ABS the opportunity to participate in a wide variety of income-generating assets. The underlying assets of an ABS are often illiquid and can't be sold on their own. So, pooling assets together and creating an ABS financial security—a process called securitization—allows the owner of the assets to make illiquid assets marketable to investors.

- Asset-backed securities (ABS) are financial securities backed by assets such as credit card receivables, home equity loans, and auto loans.
- Pooling securities into an ABS is a process called securitization.
- Although similar to mortgage-backed securities, asset-backed securities are not collateralized by mortgage-based assets.
- ABS appeal to investors looking to invest in something other than corporate debt.

Securitization of Home Loans:

All financial entities have to deal with asset liability mismatch as their assets are long-term and liabilities short-term. This is even more acute for banks and housing finance companies (HFCs) that offer home loans. Here, typical loans could be up to 30 years whereas liabilities are for 5 years. The liabilities for banks come via deposits which are more stable whereas HFCs rely on borrowings from banks and issue bonds that are less stable.

This is where securitisation comes in, which can help banks and HFCs (originators of loans) address this challenge. The originators either create or sell the loans to a special purpose vehicle (SPV). These loans are polled based on risks and returns and sold to investors as securities -- also called pass through certificates or PTCs. There are other parties such as credit rating agencies, credit enhancers and so on which help in the overall process of securitisation. One can immediately see that HFCs gain from securitisation as it helps them lighten their loan books and manage asset liability better. In turn, HFCs give more home loans enabling people to buy their own homes.

In fact, it is the very premise of promoting home ownership which led the US government to allow large scale securitisation. The home ownership, which lagged at 64 percent level in 1980s, did improve to 69 percent by the early 2000s. However, post-2008 crisis, the home-ownership has not just declined but had become even lower than 1980's by 2016. The levels have recovered marginally after 2016.

Securitization in India:

When undertaken by banks, financial institutions and non-banking financial companies ("**NBFCs**"), securitisation in India is regulated and governed by the Reserve Bank of India ("**RBI**") under the provisions of the 2006 and 2012 Guidelines on Securitisation of Standard Assets ("**RBI Guidelines**") for standard assets and by the Securitisation and Reconstruction of Financial Assets and Enforcement of Security Interest Act, 2002 ("**SARFAESI Act**") for stressed financial assets.

While the term "securitisation" is defined under each of these regulatory regimes, both regimes envisage securitisation as a ring-fenced and bankruptcy-remote true sale of financial assets (or a pool of such assets) in return for immediate cash payment. Under the true sale mechanism, the assets move from the balance sheet of the originator to the balance sheet of a special purpose vehicle ("**SPV**") or asset reconstruction company, and are pooled, sub-divided, repackaged as tradeable securities backed by such pooled assets and sold to investors either as pass through certificates ("**PTCs**") or security receipts ("**SRs**"), which represent claims on incoming cash flows from such pooled assets.

Banks and financial institutions in India also often enter into direct assignments of non-stressed financial assets under the provisions of the RBI Guidelines. Such direct assignment structures would not involve an SPV, the pooling of assets or the issuance of PTCs, and are often preferred in the Indian market by banks and financial institutions when selling down to other banks or financial institutions.

Securitisation as a structured finance mechanism has several commercial advantages, including balance sheet and risk management, increased liquidity, cost-efficient financing, marketability of the resulting securities and an opportunity for portfolio diversification, which has remained an attractive option for banks, NBFCs and financial institutions in India.

India's foray into securitisation can be traced back to 1991, when CRISIL rated the first securitisation programme in India, where Citibank securitised a pool from its auto loan portfolio and placed the paper with GIC Mutual Fund (source: RBI Report of the In-House Working Group on Asset Securitisation dated 29 December 1999).

The first significant legislation in this field in India was the SARFAESI Act, notified in 2002, which even today remains the principal legislation for the securitisation of non-performing loans and financial assets.

Under Indian stamp laws (which differ from state to state across India), securitisation and assignment transactions are subject to stamp duty, which would need to be factored into the cost of the securitisation. In several states, a deed of assignment attracts significant stamp duty, which is paid on an ad valorem basis, and in some states no distinction is made between conveyances of real estate and transfers or assignments of receivables, with both attracting similarly high stamp duties. To ensure that the stamp duty is not prohibitive and to render such transactions commercially viable and encourage securitisation, several states have issued notifications for the remission and/or reduction of stamp duties on debt assignment or securitisation transactions. Several states now have a cap on the stamp duty payable on instruments assigning loans or securitising debt with underlying security to INR 100,000. A 2016 amendment to the SARFAESI Act also eased the pricing of securitisation transactions by exempting instruments securitising or assigning non-performing financial assets in favour of asset reconstruction companies.

So far, the SARFAESI Act has provided for the securitisation of non-performing assets only. In 2006, the RBI introduced the RBI Guidelines to regulate the securitisation of standard assets (ie, non-stressed assets) by banks, NBFCs and financial institutions, to ensure the healthy development of the securitisation market in India (source: RBI notification dated 4 April 2005 releasing the draft RBI Guidelines). This was a further step towards opening up the Indian markets to securitisation transactions while providing a robust regulatory framework for such transactions. The RBI Guidelines also provide for the originator to act as servicing agent to the assignee or investors for the collection of payments due under the securitised assets on behalf of the assignee or investors.

In the wake of the global financial crisis of 2008 centred around sub-prime lending and securitisation, regulators across the globe put more robust mechanisms in place to regulate their markets. To insure against a misuse of securitisation in India, the RBI introduced revisions to the RBI Guidelines in 2012 mandating banks, NBFCs and financial institutions securitising their standard assets to retain "skin in the game" and have a continuing stake in the performance of the securitised assets, referred to as the minimum retention requirement ("**MRR**"). It was also mandated that such assets had to be held by the originating entity for a minimum length of time, being the minimum holding period ("**MHP**") that the loan or financial asset must stay on the books of an originator before it can become a part of the pool to be securitised. The MRR and MHP provided for a more effective screening of loans, requiring the originator to show a proven record of performance prior to the securitisation or assignment of such assets. Despite the stricter regulation, securitisation has remained of interest to banks and financial institutions through the years, for both securitisation and direct assignment.

DFIs in India:

Development Financial Institutions (DFIs) were established with the Government support for underwriting their losses as also the commitment for making available low cost resources for lending at a lower rate of interest than that demanded by the market for risky projects. In the initial years of development it worked well. Process of infrastructure building and industrialization got accelerated. The financial system was improved considerably as per the needs of projects.

Appraisal system of long term projects had also been strengthened due to improvement in availability of information and skills. Thus, the DFIs improved their appetite for risk associated with such projects. "The intermediaries like banks and bond markets became sophisticated in risk management techniques and wanted a piece of the pie in the long term project financing. These intermediaries also had certain distinct advantages over the traditional DFIs such as low cost of funds and benefit of diversification of loan portfolios".

The government support to DFI was also declining due to fiscal reasons or building the market more competitive and efficient. Fiscal imperatives and market dynamics have forced the government to undertake reappraisal of its policies and strategy with regard to the role of DFIs in Indian system. However, it is important to note that our country has not achieved its development goals even then due to unavoidable circumstances like economic reforms we have started the restructuring process of DFIs after 1991.

IDBI (Industrial Development Bank of India)

Industrial Development Bank of India (**IDBI Bank Limited** or **IDBI Bank** or **IDBI**) was established in 1964 by an Act to provide credit and other financial facilities for the development of the fledgling Indian industry. Many institutes of national importance finds their roots in IDBI like SIDBI, Exim bank, NSE and NSDL.

Initially it operated as a subsidiary of Reserve Bank of India and later RBI has transferred it to Government of India. On June 29, 2018 Life Insurance Corporation of India (LIC) has got a technical go-ahead from Insurance Regulatory and Development Authority of India (IRDAI) to increase stake in IDBI Bank up to 51%.[8] LIC completed acquisition of 51% controlling stake on January 21, 2019 making it the majority shareholder of the IDBI Bank. Reserve Bank of India has clarified vide a Press Release dated March 14, 2019, that IDBI Bank stands re-categorized as a Private Sector Bank for regulatory purposes with effect from January 21, 2019.

The bank has an aggregate balance sheet size of INR 3.74 trillion as on 31 March 2016.[9] It has 3,683 ATMs, 1892 branches, including one overseas branch in Dubai, 58 e-lounges and 1407 centers as of 1 February 2020.

ICICI (Industrial Credit and Investment Corporation of India)

ICICI Bank Limited is an Indian multinational banking and financial services company with its registered office in Vadodara, Gujarat and corporate office in Mumbai, Maharashtra . It offers a wide range of banking products and financial services for corporate and retail customers through a variety of delivery channels and specialised subsidiaries in the areas of investment banking, life, non-life insurance, venture capital and asset management. The bank has a network of 5,275 branches and 15,589 ATMs across India and has a presence in 17 countries.

ICICI Bank is one of the *Big Four banks* of India. The bank has subsidiaries in the United Kingdom and Canada; branches in United States, Singapore, Bahrain, Hong Kong, Qatar, Oman, Dubai International Finance Centre, China and South Africa; and representative offices in United Arab Emirates, Bangladesh, Malaysia and Indonesia. The company's UK subsidiary has also established branches in Belgium and Germany.

ICICI Bank was established by the **Industrial Credit and Investment Corporation of India (ICICI)**, an Indian financial institution, as a wholly-owned subsidiary in 1994 in Vadodara. The parent company was formed in 1955 as a joint-venture of the World Bank, India's public-sector banks and public-sector insurance companies to provide project financing to Indian industry. The bank was founded as the Industrial Credit and Investment Corporation of India Bank, before it changed its name to ICICI Bank. The parent company was later merged with the bank.

ICICI Bank launched internet Banking operations in 1998.

ICICI's shareholding in ICICI Bank was reduced to 46 percent, through a public offering of shares in India in 1998, followed by an equity offering in the form of American depositary receipts on the NYSE in 2000.[13] ICICI Bank acquired the *Bank of Madura Limited* in an all-stock deal in 2001 and sold additional stakes to institutional investors during 2001–02.

In the 1990s, ICICI transformed its business from a development financial institution offering only project finance to a diversified financial services group, offering a wide variety of products and services, both directly and through a number of subsidiaries and affiliates like ICICI Bank. In 1999, ICICI become the first Indian company and the first bank or a financial institution from non-Japan Asia to be listed on the NYSE.

In October 2001, the Boards of Directors of ICICI and ICICI Bank approved the merger of ICICI and two of its wholly-owned retail finance subsidiaries, ICICI Personal Financial Services Limited and ICICI Capital Services Limited, with ICICI Bank. The merger was approved by the Reserve Bank of India in April 2002.

In 2008, following the 2008 financial crisis, customers rushed to ICICI ATMs and branches in some locations due to rumours of an adverse financial position of ICICI Bank. The Reserve Bank of India issued a clarification on the financial strength of ICICI Bank to dispel the rumours.

In March 2020, the board of ICICI Bank Ltd. approved an investment of Rs 1,000 crore in Yes Bank Ltd. This investment resulted in ICICI Bank Limited holding in excess of a five percent shareholding in Yes Bank

IFCI (Industrial Finance Corporation of India)

IFCI, previously **Industrial Finance Corporation of India**, is a Non-Banking Finance Company in the public sector. Established in 1948 as a statutory corporation, IFCI is currently a company listed on BSE and NSE. IFCI has seven subsidiaries and one associate.

It provides financial support for the diversified growth of Industries across the spectrum. The financing activities cover various kinds of projects such as airports, roads, telecom, power, real estate, manufacturing, services sector and such other allied industries. During its 70 years of existence, mega-projects like Adani Mundra Ports, GMR Goa International Airport, Salasar Highways, NRSS Transmission, Raichur Power Corporation, among others, were set up with the financial assistance of IFCI.

The company has played a pivotal role in setting up various market intermediaries of repute in several niche areas like stock exchanges, entrepreneurship development organisations, consultancy organisations, educational and skill development institutes across the length and breadth of the country.

The Govt. of India has placed a Venture Capital Fund of Rs. 200 crore for Scheduled Castes (SC) with IFCI with an aim to promote entrepreneurship among the Scheduled Castes (SC) and to provide concessional finance. IFCI has also committed a contribution of Rs.50 crore as lead investor and Sponsor of the Fund. IFCI Venture Capital Funds Ltd., a subsidiary of IFCI Ltd., is the Investment Manager of the Fund. The Fund was operationalized during FY 2014-15 and IVCF is continuously making efforts for meeting the stated objective of the scheme.

Further, the Government of India designated IFCI as a nodal agency for the “Scheme of Credit Enhancement Guarantee for Scheduled Caste (SC) Entrepreneurs” in March, 2015, with the objective of encouraging entrepreneurship in the lower strata of society. Under the scheme, IFCI would provide guarantees to banks against loans to young and start-up entrepreneurs belonging to scheduled castes.

Until the establishment of ICICI in 1991, IFCI remained solely responsible for implementation of the government's industrial policy initiatives.

On 1 July 1993, it was reconstituted as a company to impart higher degree of operational flexibility. Because there was NPA increase and it was making loss then gov privatised it. IFCI was allowed to access the capital markets directly.

NABARD (National Bank for Agriculture and Rural Development)

National Bank for Agriculture and Rural Development (**NABARD**) is an Apex Development Financial Institution in India.
The Bank has been entrusted with "matters concerning Policy Planning and Operations in the field of credit for Agriculture and other Economic activities in Rural areas in India". NABARD is active in developing Financial Inclusion policy.

NABARD was established on the recommendations of B.Sivaramman Committee, (by Act 61, 1981 of Parliament) on 12 July 1982 to implement the *National Bank for Agriculture and Rural Development Act 1981*. It replaced the Agricultural Credit Department (ACD) and Rural Planning and Credit Cell (RPCC) of Reserve Bank of India, and Agricultural Refinance and Development Corporation (ARDC). It is one of the premier agencies providing developmental credit in rural areas. NABARD is India's specialised bank for Agriculture and Rural Development in India.

The initial corpus of NABARD was Rs.100 crores. Consequent to the revision in the composition of share capital between Government of India and RBI, the paid up capital as on 31 May 2017, stood at Rs.6,700 crore with Government of India holding Rs.6,700 crore (100% share). The authorized share capital is Rs.30,000 crore.

International associates of NABARD include World Bank-affiliated organisations and global developmental agencies working in the field of agriculture and rural development. These organizations help NABARD by advising and giving monetary aid for the upliftment of the people in the rural areas and optimising the agricultural process.

RRBs (Regional Rural Banks)

Regional Rural Banks (RRBs) are Indian Scheduled Commercial Banks (Government Banks) operating at regional level in different States of India. They have been created with a view of serving primarily the rural areas of India with basic banking and financial services. However, RRBs may have branches set up for urban operations and their area of operation may include urban areas too.

The area of operation of RRBs is limited to the area as notified by Government of India covering one or more districts in the State. RRBs also perform a variety of different functions. RRBs perform various functions in following heads:

- Providing banking facilities to rural and semi-urban areas.
- Carrying out government operations like disbursement of wages of MGNREGA workers, distribution of pensions etc.
- Providing Para-Banking facilities like locker facilities, debit and credit cards, mobile banking, internet banking,UPI etc.
- Small financial banks.
    - Regional Rural Banks were established under the provisions of an Ordinance passed on 26 September 1975 and the RRB Act 1976 to provide sufficient banking and credit facility for agriculture and other rural sectors.As a result, Five Regional Rural Banks were set up on 2 October 1975,Gandhi Jayanti. These were set up on the recommendations of The narshimham committee Working Group[1] during the tenure of Indira Gandhi's Government with a view to include rural areas into economic mainstream since that time about 70% of the Indian Population was of Rural Orientation. The development process of RRBs started on 2 October 1975,Gandhi Jayanti with the forming of the five RRBs. First RRB,the Prathama Bank,Head Office at Moradabad (U.P.) with authorised capital of Rs 5 crore at its starting. Prathama bank was sponsored by Syndicate Bank.As on 2 October,1975 Out of the remaining four RRBs in the country one was Set up at Malda in West Bengal under the name of Gaur Gramin Bank,(Sponsored Bank:UCO Bank) which was the first RRB in the Eastern Region of India.Other three RRBs are Gorakhpur Kshetriya Gramin Bank,Gorakhpur,U.P.(Sponsored Bank:SBI),Haryana Kshetriya Gramin Bank Bhiwani,Haryana (Sponsored Bank:PNB),Jaipur-Nagpur Anchalik Gramin Bank Jaipur,Rajasthan (Sponsored Bank:UCO Bank).
    - The Regional Rural Banks were owned by the Central Government, the State Government and the Sponsor Bank (Any commercial bank can sponsor the regional rural banks) who held shares in the ratios as follows Central Government – 50%, State Government – 15% and Sponsor Banks – 35%.

State Level Institutions:

There are two important development agencies constituted at which provide financial assistance for setting up of industrial project small and medium-scale sector. These institutions also part modernisation, expansion and diversification programmes of existing units. The area of operation of these state level institutions is limited respective state.

STATE FINANCIAL CORPORATIONS (SFCs)

State Financial Corporations have been established under the Financial Corporation Act, 1951. At present there are 18 SFCs operating states as per list given in Appendix 9.I State Financial Corporation,, provide long-term finance for setting up of the smaller projects within their region.

The State Financial Corporations (SFCs), operating as development are state-level financial institutions, playing a crucial role in the level small and medium enterprises in the states in tandem with the national

The SFCs provide financial assistance by way of term loan, subscription to equity/debentures, guarantees, discounting of bills of and seed/special capital. The SFCs operate a number of schemes of and equity type assistance on behalf of IDBI/SIDBI, in addition to the schemes for artisans, and special target groups such as SC/ST, women, ex-servicemen and physically handicapped.

The SFCs (Amendment) Act, 2000 which became effective in 2000, provide greater flexibility to the SFCs to cope with the challenges by the deregulated financial system.

STATE INDUSTRIAL DEVELOPMENT CORPORATIONS (SIDCs*)*

The State Industrial Development Corporations (SIDCs) were c under the Companies Act, 1956 as wholly owned undertakings of the governments with the specific objectives of promoting and developing and large industries in their respective states/union territories. These cc extend financial assistance in the form of rupee loans, underwriting subscriptions to shares/debentures, guarantees, inter-corporate de also opens letters of credit on behalf of its borrowers. SIDCs undertake of promotional activities including preparation of feasibility reports, conducting industrial potential, surveys entrepreneurship training & development programmes and developing industrial areas/estates. Some SIDCs also offer a package of developmental services that include technical guidance, assistance in plant location and co-ordination with other agencies. With a view to providing infrastructural facilities for the establishment of industrial units, SIDCs are involved in the setting up of industrial growth centres. To keep pace with the hanging economic environment, SIDCs have initiated various measures to expand the scope of their activities and have entered into various fee-based activities.

Of the various SIDCs in the country, those in Andaman & Nicobar, Arunachal Pradesh, Daman & Diu and Dadra & Nagar Haveli, Goa, Manipur, Meghalaya, Mizoram, Nagaland, Tripura, Pondicherry and Sikkim also act as SFCs to provide assistance to small and medium enterprises and act as promotional agencies for this sector.

State Industrial Development Corporation operate at slightly higher level than SFCs though these institutions are also primarily working as development banks promoting industrial projects in small and medium scale. A list of SIDCs given in Appendix 9.II.

Unit-IV: Management of Financial Services:

Leasing and Hire Purchase:

A lease is a contract outlining the terms under which one party agrees to rent property owned by another party. It guarantees the lessee, also known as the tenant, use of an asset and guarantees the lessor, the property owner or landlord, regular payments for a specified period in exchange. Both the lessee and the lessor face consequences if they fail to uphold the terms of the contract. It is a form of incorporeal right.

A **lease** is a contractual arrangement calling for the lessee (user) to pay the lessor (owner) for use of an asset. Property, buildings and vehicles are common assets that are leased. Industrial or business equipment is also leased.

Broadly put, a lease agreement is a contract between two parties, the lessor and the lessee. The lessor is the legal owner of the asset; the lessee obtains the right to use the asset in return for regular rental payments. The lessee also agrees to abide by various conditions regarding their use of the property or equipment. For example, a person leasing a car may agree that the car will only be used for personal use.

The narrower term **rental agreement** can be used to describe a lease in which the asset is tangible property. Language used is that the user *rents* the land or goods *let out* or *rented out* by the owner. The verb *to lease* is less precise because it can refer to either of these actions. Examples of a lease for intangible property are use of a computer program (similar to a license, but with different provisions), or use of a radio frequency (such as a contract with a cell-phone provider).

The term **rental agreement** is also sometimes used to describe a periodic lease agreement (most often a month-to-month lease) internationally and in some regions of the United States.

Common elements of a lease agreement include:

- Names of the parties of the agreement.
- The starting date and duration of the agreement.
- Identifies the specific object (by street address, VIN, or make/model,serial number) being leased.
- Provides conditions for renewal or non-renewal.
- Has a specific consideration (a lump sum, or periodic payments) for granting the use of this object.
- Has provisions for a security deposit and terms for its return.
- May have a specific list of conditions which are therein described as Default Conditions and specific Remedies.
- May have other specific conditions placed upon the parties such as:
  - Need to provide insurance for loss.
  - Restrictive use.
  - Which party is responsible for maintenance.
- Termination clause (describing what will happen if the contract is ended early or cancelled, stating the rights of parties to terminate the lease, and their obligations)

Evaluation of Lease Transaction:

Leasing is a contract between the owner(lesser) and the lessee for the hiring of a specific assets. Leasing can apply to any fixed assets and quite commonly used for plant and machinery, office equipment and motors vehicles. Instead of acquiring these assets for itself, the company enters into an agreement with a leasing company whereby the latter purchase the assets in question and then lease them (rent or hire them) on a long-term basis to the former. No initial funds are required but there is instead a regular charge for lease payments to be charged in the profit and loss account. The lessee obtains possession and use of the asset in exchange for the rentals, while the lessor retains legal ownership.
Leases are of two types:
a) operating Leases, and
b) finance leases
Operating lease is one where an asset leased or hired for a period of time substantially less than that of its useful life. A finance lease is one which last for the whole of an asset's useful life and where the lessee effectively takes all the risks and benefits associated with ownership.

Leasing an asset from the lessor or purchase of asset by borrowing the full purchase price of asset should be compared as financing alternatives that are dependent on the investment decision. As such, such investment have been evaluated as part of a company's capital budgeting process and mostly use the NPV method by analysis using the after tax cost of debt as the discount rate for decision making. It means a firm should evaluate whether to purchase an asset or acquire by leasing. Lease rental payments are similar to the payments of interest on debt so leasing may be an good alternative to borrowing for the firm. Thus, lease financing is made using NPV method using the after-tax cost of debt as the discount rate.

Steps Involve In Evaluating the Lease Or Purchase For Decision Making:

1. Determine the after tax cash outflow for each year under lease alternative as under: (Lease payment amount - tax benefit on lease payment=$..) tax rate X lease payment

2. Determine the NPV of after tax cash outflow amount using after tax cost of capital (cost of capital X tax rate) or Cost of capital(1-tax rate). That is, determine PV of cash flows associated with the leasing alternative.

3. Determine the after tax cash outflow under buying alternative based on borrowing (PV of purchase price - PV of tax benefits of depreciation provided). That is, PV of cash flow associated with the buying alternative will be ascertained.

4. The decision between buying or leasing will be made by comparing the NPV under each of the alternatives. The alternative having lower NPV will be preferred

Types of Lease and Their Implications:

1. Financial Lease

Financial leasing is a contract involving payment over a longer period. It is a long-term lease and the lessee will be paying much more than the cost of the property or equipment to the lessor in the form of lease charges. It is irrevocable. In this type of leasing the lessee has to bear all costs and the lessor does not render any service.

2. Operating Lease

In an operating lease, the lessee uses the asset for a specific period. The lessor bears the risk of obsolescence and incidental risks. There is an option to either party to terminate the lease after giving notice. In this type of leasing

- lessor bears all expenses
- lessor will not be able to realize the full cost of the asset
- specialized services are provided by the lessor.

This kind of lease is preferred where the equipment is likely to suffer obsolescence.

3. Leveraged and non-leveraged leases

In leveraged and non-leveraged leases, the value of the asset leased may be of a huge amount which may not be possible for the lessor to finance. So, the lessor involves one more financier who will have charge over the leased asset.

4. Conveyance type lease

In Conveyance type lease, the lease will be for a long-period with a clear intention of conveying the ownership of title on the lessee.

5. Sale and leaseback

In a sale and leaseback, a company owning the asset sells it to the lessor. The lessor pays immediately for the asset but leases the asset to the seller. Thus, the seller of the asset becomes the lessee. The asset remains with the seller who is a lessee but the ownership is with the lessor who is the buyer. This arrangement is done so that the selling company obtains finance for running the business along with with the asset.

6. Full and non-payout lease

A full pay-out lease is one in which the lessor recovers the full value of the leased asset by way of leasing. In case of a non pay-out lease, the lessor leases out the same asset over and over again.

7. Specialized service lease

The lessor or the owner of the asset is a specialist of the asset which he is leasing out. He not only leases out but also gives specialized personal service to the lessee. Examples are electronic goods, automobiles, air-conditioners, etc.

8. Net and non-net lease

In non-net lease, the lessor is in charge of maintenance insurance and other incidental expenses. In a net lease, the lessor is not concerned with the above maintenance expenditure. The lessor confines only to financial service.

9. Sales aid lease

In case, the lessor enters into any tie up arrangement with manufacturer for the marketing, it is called sales aid lease.

10. Cross border lease

Lease across national frontiers are called cross border lease, Shipping, air service, etc., will come under this category.

11. Tax oriented lease

Where the lease is not a loan on security but qualifies as a lease, it will be considered a tax oriented lease.

12. Import Lease

In an Import lease, the company providing equipment for lease may be located in a foreign country but the lessor and the lessee may belong to the same country. The equipment is more or less imported.

13. International lease

Here, the parties to the lease transactions may belong to different countries which is almost similar to cross border lease.

Hire Purchase:

Hire purchase is an arrangement for buying expensive consumer goods, where the buyer makes an initial down payment and pays the balance plus interest in instalments. The term hire purchase is commonly used in the United Kingdom and it's more commonly known as an instalment plan in the United States. However, there can be a difference between the two: With some instalment plans, the buyer gets the ownership rights as soon as the contract is signed with the seller. With hire purchase agreements, the ownership of the merchandise is not officially transferred to the buyer until all the payments have been made.

A **hire purchase** (HP), known as **instalment plan** is an arrangement whereby a customer agrees to a contract to acquire an asset by paying an initial instalment (e.g. 40% of the total) and repays the balance of the price of the asset plus interest over a period of time. Other analogous practices are described as closed-end leasing or rent to own.

The hire purchase agreement was developed in the United Kingdom in the 19th century to allow customers with a cash shortage to make an expensive purchase they otherwise would have to delay or forgo. For example, in cases where a buyer cannot afford to pay the asked price for an item of property as a lump sum but can afford to pay a percentage as a deposit, a hire-purchase contract allows the buyer to hire the goods for a monthly rent. When a sum equal to the original full price plus interest has been paid in equal instalments, the buyer may then exercise an option to buy the goods at a predetermined price (usually a nominal sum) or return the goods to the owner.

If the buyer defaults in paying the instalments, the owner may repossess the goods. A vendor protection not available with unsecured-consumer-credit systems. HP is frequently advantageous to consumers because it spreads the cost of expensive items over an extended time period. Business consumers may find the different balance sheet and taxation treatment of hire-purchased goods beneficial to their taxable income. The need for HP is reduced when consumers have collateral or other forms of credit readily available.

These contracts are most commonly used for items such as car and high value electrical goods where the purchasers are unable to pay for the goods directly.

The seller and the owner

If the seller has the resources and the legal right to sell the goods on credit (which usually depends on a licensing system in most countries), the seller and the owner will be the same person. But most sellers prefer to receive a cash payment immediately. To achieve this, the seller transfers ownership of the goods to a Finance Company, usually at a discounted price, and it is this company that hires and sells the goods to the buyer. This introduction of a third party complicates the transaction. Suppose that the seller makes false claims as to the quality and reliability of the goods that induce the buyer to "buy". In a conventional contract of sale, the seller will be liable to the buyer if these representations prove false. But, in this instance, the seller who makes the representation is not the owner who sells the goods to the buyer only after all the instalments have been paid. To combat this, some jurisdictions, including Ireland, make the seller and the finance house jointly and severally liable to answer for breaches of the purchase contract.

Size and Scope of Hire Purchase:

Hire purchase is a method of purchasing or financing capital goods whereby the goods are accessible for use almost instantaneously but the payment is made in smaller parts over an agreed period. The ownership is transferred only after the paying all instalments.Technically speaking, it is an agreement between the buyer (or user) of the asset and the financing company whereby the financing company purchases the asset on behalf of the buyer and the buyer utilized it for business purpose and pays back to the financing company in small instalments called hire charges.

In other words, hire purchase can be defined as an option of financing or acquiring an asset for use whereby the financing company let the goods on hire to the buyer against small instalments called hire charges and the buyer gets the right to use the asset with an option to purchase the asset by paying all such instalments spread over a period of time. Hire purchase was very prominent for vehicle financing whether that is a personal car, commercial vehicle etc. but now equipment, machinery etc. are also financed with hire purchase method.

Difference between Hire Purchase and Lease

OWNERSHIP OF THE ASSET

In a lease, ownership lies with the lessor. The lessee has the right to use the equipment and does not have the option to purchase. Whereas in hire purchase, the hirer has the option to purchase. The hirer becomes the owner of the asset/equipment immediately after the last instalment is paid.

DEPRECIATION
In lease financing, the depreciation is claimed as an expense in the books of the lessor. On the other hand, the depreciation claim is allowed to the hirer in the case of hire purchase transaction.

RENTAL PAYMENTS
The lease rentals cover the cost of using an asset. Normally, it is derived with the cost of an asset over the asset life. In the case of hire purchase, instalment is inclusive of the principal amount and the interest for the time period the asset is utilized.
DURATION
Generally, lease agreements are done for longer duration and for bigger assets like land, property etc. Hire Purchase agreements are done mostly for shorter duration and cheaper assets like hiring a car, machinery etc.

TAX IMPACT
In the lease agreement, the total lease rentals are shown as expenditure by the lessee. In hire purchase, the hirer claims the depreciation of asset as an expense.

REPAIRS AND MAINTENANCE
Repairs and maintenance of the asset in the financial lease are the responsibility of the lessee but in operating lease, it is the responsibility of the lessor. In hire purchase, the responsibility lies with the hirer.

THE EXTENT OF FINANCE
Lease financing can be called the complete financing option in which no down payments are required but in the case of hire purchase, the normally an amount of margin money is required to be paid upfront by the hirer. Therefore, we call it a partial finance like loans etc.

Businessmen can opt option of lease finance or the hire purchase but they should be analysed properly as to how much the options suits to the business requirement and situations.

A SUMMARY OF TABULAR PRESENTATION OF DIFFERENCES BETWEEN LEASE AND HIRE PURCHASE

Points of Distinction	Leasing	Hire Purchase
Ownership	Lessor is the owner until the end of the agreement	Hirer has the option of purchasing the asset at the end of the agreement
Duration	Done for longer duration	Done for a shorter duration
Depreciation	Lessor claims the depreciation	Hirer claims the depreciation

Payments	Rental payments are the cost of using the asset	Payments include the principal amount and the effective interest for the duration of the agreement
Tax Impact	Lease rentals categorized as expenditure by the lessee	Only interest component is categorized as expenditure by the hirer
The Extent of Financing	Complete financing	Partial financing
Repairs and Maintenance	Responsibility of the lessee in the financial lease, and of the lessor in operating lease	Responsibility of the hirer

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Implications of Hire Purchase and Lease for the Business:

Three key considerations:

1. Leasing and hire purchase are both forms of asset finance that can be used to acquire assets for the business.
2. This a low-risk form of debt finance that is often used if the business requires new equipment, which would otherwise be unaffordable due to cash-flow constraints.
3. Leasing and hire purchase can be useful to businesses at any stage. Both forms of debt are secured against the new assets, so available to both start-ups and large, established organisations.

Leasing and hire purchase are types of finance used by businesses to obtain a wide range of assets – everything from office equipment to vehicles. Leasing and hire purchase could be the perfect solution if you need new equipment which would otherwise be unaffordable because of cash-flow constraints. Because leases and hire-purchase agreements are secured wholly or largely on the asset being financed, the need for additional collateral is much reduced. There is more security for the user because the finance cannot be recalled during the life of the agreement, provided the business keeps up with payments.

Other Financial Services:

Factoring: Factoring is a financial transaction and a type of debtor finance in which a business *sells* its accounts receivable (i.e., invoices) to a third party (called a factor) at a discount. A business will sometimes factor its receivable assets to meet its present and immediate cash needs. Forfaiting is a factoring arrangement used in international trade finance by exporters who wish to sell their receivables to a forfaiter. Factoring is commonly referred to as accounts receivable factoring, invoice factoring, and sometimes accounts receivable financing. Accounts receivable financing is a term more accurately used to describe a form of asset based lending against accounts receivable. The Commercial Finance Association is the leading trade association of the asset-based lending and factoring industries.

There are three parties directly involved: the *factor* who purchases the receivable, the one who sells the receivable, and the debtor who has a financial liability that requires him or her to make a payment to the owner of the invoice. The receivable, usually associated with an invoice for work performed or goods sold, is essentially a financial asset that gives the owner of the receivable the legal right to collect money from the debtor whose financial liability directly corresponds to the receivable asset. The seller *sells* the receivables at a discount to the third party, the specialized financial organization (aka the factor) to obtain cash. This process is sometimes used in manufacturing industries when the immediate need for raw material outstrips their available cash and ability to purchase "on account". Both invoice discounting and *factoring* are used by B2B companies to ensure they have the immediate cash flow necessary to meet their current and immediate obligations.[5][2] Invoice factoring is not a relevant financing option for retail or B2C companies because they generally do not have business or commercial clients, a necessary condition for factoring.

The *sale* of the receivable transfer's ownership of the receivable to the factor, indicating the factor obtains all of the rights associated with the receivables. Accordingly, the receivable becomes the factor's asset, and the factor obtains the right to receive the payments made by the debtor for the invoice amount, and is free to pledge or exchange the receivable asset without unreasonable constraints or restrictions. Usually, the account debtor is notified of the sale of the receivable, and the factor bills the debtor and makes all collections; however, non-notification factoring, where the client (seller) collects the accounts sold to the factor, as agent of the factor, also occurs. The arrangement is usually confidential in that the debtor is not notified of the assignment of the receivable and the seller of the receivable collects the debt on behalf of the factor. If the factoring transfers the receivable "**without recourse**", the factor (purchaser of the receivable) must bear the loss if the account debtor does not pay the invoice amount. If the factoring transfers the receivable "**with recourse**", the factor has the right to collect the unpaid invoice amount from the transferor (seller). However, any merchandise returns that may diminish the invoice amount that is collectible from the accounts receivable are typically the responsibility of the seller, and the factor will typically hold back paying the seller for a portion of the receivable being *sold* (the "factor's holdback receivable") in order to cover the merchandise returns associated with the factored receivables until the privilege to return the merchandise expires.

There are four principal parts to the factoring transaction, all of which are recorded separately by an accountant who is responsible for recording the factoring transaction:

1. the "fee" paid to the factor,
2. the Interest Expense paid to the factor for the advance of money,
3. the "bad debt expense" associated with portion of the receivables that the seller expects will remain unpaid and uncollectable,
4. the "factor's holdback receivable" amount to cover merchandise returns, and (e) any additional "*loss*" or "*gain*" the seller must attribute to the sale of the receivables. Sometimes the factor's charges paid by the seller (the factor's "client") covers a discount fee, additional credit risk the factor must assume, and other services provided. The factor's overall profit is the difference between the price it paid for the invoice and the money received from the debtor, less the amount lost due to non-payment.

Forfeiting: In trade finance, **forfaiting** is a service providing medium-term financial support for export/import of capital goods. The third party providing the support is termed the forfaiter. The forfaiter provides medium-term finance to, and will commonly also take on certain risks from, the importer; and takes on all risk from the exporter, in return for a margin. Payment may be by negotiable instrument, enabling the forfaiter to lay off some risks. Like factoring, forfaiting involves sale of financial assets from the seller's receivables. Key differences are that forfait supports the buyer (importer) as well as the seller (exporter), and is available only for export/import transactions and in relation to capital goods. The word *forfaiting* is derived from the French word *forfait*, meaning to relinquish a right (in this case, the exporter's right to receive payment from the customer - the importer).

Characteristics

The characteristics of a forfaiting transaction are:

- Credit is extended to the importer for a period of between 180 days and seven years.
- The minimum bill size is normally $250,000, although $500,000 is preferred.
- The payment is normally receivable in any major convertible currency.
- A letter of credit or a guarantee is made by a bank, usually in the importer's country.
- The contract can be for either goods or services.

At its simplest, the receivables should be evidenced by a promissory note, a bill of exchange, a deferred-payment letter of credit, or a letter of forfaiting.

Pricing

Three elements relate to the pricing of a forfaiting transaction:

- Discount rate, the interest element, usually quoted as a margin over LIBOR.
- Days of grace, added to the actual number of days until maturity for the purpose of covering the number of days normally experienced in the transfer of payment, applicable to the country of risk.
- Commitment fee, applied from the date the forfaiter is committed to undertake the financing, until the date of discounting.

The benefits to the exporter from forfaiting include eliminating political, transfer, and commercial risks and improving cash flows. The benefit to the forfaiter is the extra margin on the loan to the exporter.

Discounting of Bills

The terms 'invoice discounting' or 'bills discounting' or 'purchase of bills' are all same. Invoice discounting is a source of working capital finance for the seller of goods on credit. Bill discounting is an arrangement whereby the seller recovers an amount of sales bill from the financial intermediaries before it is due. Such intermediaries charge a fee for the service. From the other side, it is a business vertical for all types of financial intermediaries such as banks, financial institutions, NBFCs, etc.

Invoice discounting can be technically defined as the selling of bill to invoice discounting company before the due date of payment at a value which is less than the invoice amount. The difference between the bill amount and the amount paid is the fee of the invoice discounting to the company. The fee will depend on the period left before payment date, amount and the perceived risk.

The bills or invoices under bill discounting are legally the 'bill of exchange'. A bill of exchange is a negotiable instrument which is negotiable mere by endorsing the name. For example our currency is an example of bill of exchange. Currency provides value written over it to the bearer of the instrument. In the case of bill discounting, such bills can be either payable to the bearer or payable to order. Therefore, after discounting a bill, a bank can further get the bill discounted from other banks in case of cash flow requirement.

Rediscounting of Bills:

A rediscount occurs when a short-term negotiable debt instrument is discounted for a second time. The reason an issuer would do this is to cause a shift in a market that has a high demand for loans. When liquidity in the market is low, banks can raise cash by rediscounting. A rediscount is also a method for banks to obtain financing from a central bank.

- Rediscount refers to discounting a debt instrument for a second time, increasing the difference between the discount price and the par value.
- Rediscounting occurs to shift a market where there is a high demand for loans.
- Rediscount also refers to financing provided by central banks to banks.
- The central bank will rediscount a discounted promissory note from a borrower to a bank to generate liquidity for the bank.

Consumer Credit:

Consumer credit is personal debt taken on to purchase goods and services. A credit card is one form of consumer credit. Although any type of personal loan could be labelled consumer credit, the term is usually used to describe unsecured debt that is taken on to buy everyday goods and services. It is not usually used to describe the purchase of a house, for example, which is considered a long-term investment and is usually purchased with a secured mortgage loan. Consumer credit is also known as consumer debt.

Consumer credit is extended by banks, retailers, and others to enable consumers to purchase goods immediately and pay off the cost over time with interest. It is broadly divided into two classifications: instalment credit and revolving credit.

- Instalment credit is used for a specific purpose and is issued for a set period of time.
- Revolving credit is an open-ended loan that may be used for any purchase.
- The disadvantage of revolving credit is the cost to those who fail to pay off their entire balances every month and continue to accrue additional interest charges.
- The average American had a credit card balance of $6,200 in early 2020, according to Equifax.

Plastic Money: In general, debit cards & credit cards are called as plastic money. Plastic money has provided us with the ease of conducting transactions in our day to day life. It has definitely replaced cash transactions to a great extent all over the world and has emerged as an essential form of ready money. It has made it too easy for us to buy things we normally could not afford and in such a scenario it is important to understand the merits and demerits of plastic money.

Plastic Money is emerged at the end of 20th century following the introduction of credit cards. At the beginning credit card was classified also as a credit more but introduction of debit card and ATM cards influenced the establishments of another form of currency that is plastic money.

PIN (Personal Identification Number) code is required to perform transaction with the plastic money.

Examples of Plastic money are

- Credit Card
- Debit Card
- ATM Car d
- Smart Card

Uses of Plastic Money: Yes plastic money is use of technology for transferring money into another bank account for your goods and services. Have we realized why is government getting so specific about using technology for transferring money from one account to another? These transfers need not be just within the same bank or the same persons bank account, it can be a third party transfer into either the same bank or any other bank, in the same city or to another city, even transfer of money to another county is possible using technology.

Technology has taken over the globe and it dominates as it is used in almost all types of businesses, companies and industries. No industry on this planet now can survive without technology these days. Reason is extremely clear, with growing modernization and businesses it is important to simplify the everything by maintain records, use various methods to track business, compare yourself with your competitors, etc. everything, almost everything can be made possible with the use of technology.