Khandelwal Vaish Girls Institute of Technology

Internal Examination 2017 - 18

Management of Financial Services

MBA Semester III

Question Paper & Answer Key

MM: 30 Time : 02:30 hours

1. **What is financial services and explain structure of Indian financial structure.** (4)

Ans. F**inancial services** are the services provided by the Financial Institutions. These services generally include the **banking services, Foreign exchange services, investment services, insurance services** and few others. Following is a very brief description of the services:

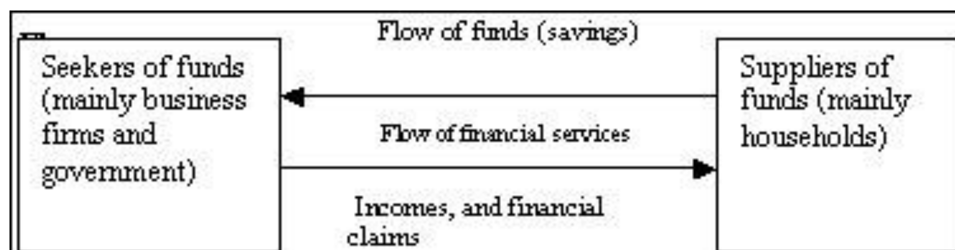
- **Banking Services** – Includes all the operations provided by the banks including to the simple deposit and withdrawal of money to the issue of loans, credit cards etc.
- **Foreign Exchange services** – this includes the currency exchange, foreign exchange banking or the wire transfer.
- **Investment Services** – It generally includes the asset management, hedge fund management and the custody services.
- **Insurance Services** – It deals with the selling of insurance policies, brokerages, insurance underwriting or the reinsurance.
- Some of the other services include the advisory services, venture capital, angel investment etc.

Indian Financial System

The economic development of a nation is reflected by the progress of the various economic units, broadly classified into corporate sector, government and household sector. While performing their activities these units will be placed in a surplus/deficit/balanced budgetary situations.

There are areas or people with surplus funds and there are those with a deficit. A financial system or financial sector functions as an intermediary and facilitates the flow of funds from the areas of surplus to the areas of deficit. A Financial System is a composition of various institutions, markets, regulations and laws, practices, money manager, analysts, transactions and claims and liabilities.

Financial System



The word "system", in the term "financial system", implies a set of complex and closely connected or interlined institutions, agents, practices, markets, transactions, claims, and liabilities in the economy. The financial system is concerned about money, credit and finance-the three terms are intimately related yet are somewhat different from each other. Indian financial system consists of financial market, financial instruments and financial intermediation. These are briefly discussed below:

FINANCIAL MARKETS

A Financial Market can be defined as the market in which financial assets are created or transferred. As against a real transaction that involves exchange of money for real goods or services, a financial transaction involves creation or transfer of a financial asset. Financial Assets or Financial Instruments represents a claim to the payment of a sum of money sometime in the future and /or periodic payment in the form of interest or dividend.

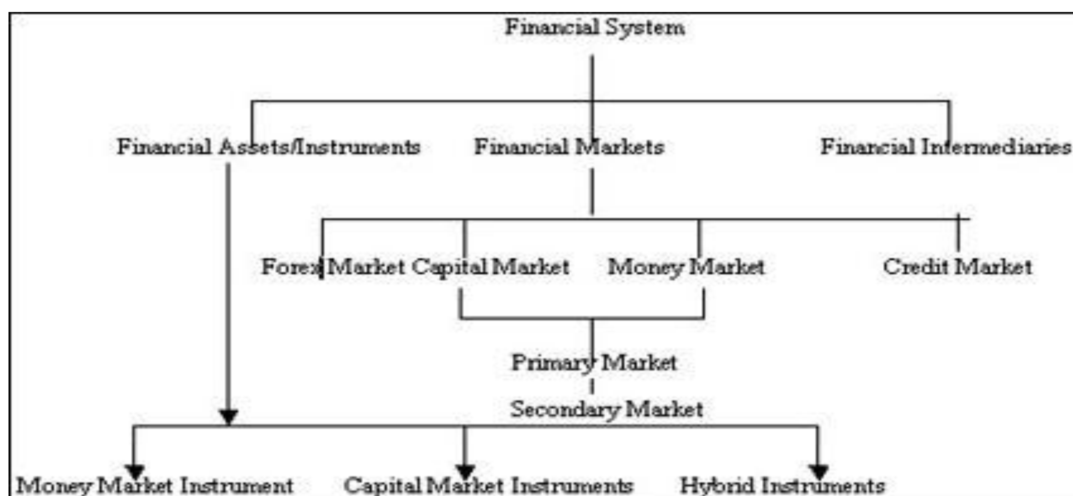
Money Market- The money market ifs a wholesale debt market for low-risk, highly-liquid, short-term instrument. Funds are available in this market for periods ranging from a single day up to a year. This market is dominated mostly by government, banks and financial institutions.

Capital Market - The capital market is designed to finance the long-term investments. The transactions taking place in this market will be for periods over a year.

Forex Market - The Forex market deals with the multicurrency requirements, which are met by the exchange of currencies. Depending on the exchange rate that is applicable, the transfer of funds takes place in this market. This is one of the most developed and integrated market across the globe.

Credit Market- Credit market is a place where banks, FIs and NBFCs purvey short, medium and long-term loans to corporate and individuals.

Constituents of a Financial System



Financial Intermediation

Having designed the instrument, the issuer should then ensure that these financial assets reach the ultimate investor in order to garner the requisite amount. When the borrower of funds approaches the financial market to raise funds, mere issue of securities will not suffice. Adequate information of the issue, issuer and the security should be passed on to take place. There should be a proper channel within the financial system to ensure such transfer. To serve this purpose, **Financial intermediaries** came into existence. Financial intermediation in the organized sector is conducted by a wide range of institutions functioning under the overall surveillance of the Reserve Bank of India. In the initial stages, the role of the intermediary was mostly related to ensure transfer of funds from the lender to the borrower. This service was offered by banks, FIs, brokers, and dealers. However, as the financial system widened along with the developments taking place in the financial markets, the scope of its operations also widened. Some of the important intermediaries operating in the financial markets include; investment bankers, underwriters, stock exchanges, registrars, depositories, custodians, portfolio managers, mutual funds, financial advertisers financial consultants, primary dealers, satellite dealers, self regulatory organizations, etc. Though the markets are different, there may be a few intermediaries offering their services in more than one market e.g. underwriter. However, the services offered by them vary from one market to another.

Intermediary	Market	Role
Stock Exchange	Capital Market	Secondary Market to securities
Investment Bankers	Capital Market, Credit Market	Corporate advisory services, Issue of securities
Underwriters	Capital Market, Money Market	Subscribe to unsubscribed portion of securities
Registrars, Depositories, Custodians	Capital Market	Issue securities to the investors on behalf of the company and handle share transfer activity
Primary Dealers Satellite Dealers	Money Market	Market making in government securities
Forex Dealers	Forex Market	Ensure exchange ink currencies

Financial Instruments

Money Market Instruments

The money market can be defined as a market for short-term money and financial assets that are near substitutes for money. The term short-term means generally a period up to one year and near substitutes to money is used to denote any financial asset which can be quickly converted into money with minimum transaction cost.

Some of the important money market instruments are briefly discussed below;

- Call/Notice Money

- Treasury Bills
- Term Money
- Certificate of Deposit
- Commercial Papers

a. **Call /Notice-Money Market**: Call/Notice money is the money borrowed or lent on demand for a very short period. When money is borrowed or lent for a day, it is known as Call (Overnight) Money. Intervening holidays and/or Sunday are excluded for this purpose. Thus money, borrowed on a day and repaid on the next working day, (irrespective of the number of intervening holidays) is "Call Money". When money is borrowed or lent for more than a day and up to 14 days, it is "Notice Money". No collateral security is required to cover these transactions.

b. **Inter-Bank Term Money**: Inter-bank market for deposits of maturity beyond 14 days is referred to as the term money market. The entry restrictions are the same as those for Call/Notice Money except that, as per existing regulations, the specified entities are not allowed to lend beyond 14 days.

c. **Treasury Bills:** Treasury Bills are short term (up to one year) borrowing instruments of the union government. It is an IOU of the Government. It is a promise by the Government to pay a stated sum after expiry of the stated period from the date of issue (14/91/182/364 days i.e. less than one year). They are issued at a discount to the face value, and on maturity the face value is paid to the holder. The rate of discount and the corresponding issue price are determined at each auction.

d. **Certificate of Deposits**: Certificates of Deposit (CDs) is a negotiable money market instrument and issued in dematerialized form or as a usance Promissory Note, for funds deposited at a bank or other eligible financial institution for a specified time period. Guidelines for issue of CDs are presently governed by various directives issued by the Reserve Bank of India, as amended from time to time. CDs can be issued by (i) scheduled commercial banks excluding Regional Rural Banks (RRBs) and Local Area Banks (LABs); and (ii) select all-India Financial Institutions that have been permitted by RBI to raise short-term resources within the umbrella limit fixed by RBI. Banks have the freedom to issue CDs depending on their requirements. An FI may issue CDs within the overall umbrella limit fixed by RBI, i.e., issue of CD together with other instruments viz., term money, term deposits, commercial papers and inter corporate deposits should not exceed 100 per cent of its net owned funds, as per the latest audited balance sheet.

e. **Commercial Paper**: CP is a note in evidence of the debt obligation of the issuer. On issuing commercial paper the debt obligation is transformed into

an instrument. CP is thus an unsecured promissory note privately placed with investors at a discount rate to face value determined by market forces. CP is freely negotiable by endorsement and delivery. A company shall be eligible to issue CP provided - (a) the tangible net worth of the company, as per the latest audited balance sheet, is not less than Rs. 4 crore; (b) the working capital (fund-based) limit of the company from the banking system is not less than Rs.4 crore and (c) the borrowed account of the company is classified as a Standard Asset by the financing bank/s. The minimum maturity period of CP is 7 days. The minimum credit rating shall be P-2 of CRISIL or such equivalent rating by other agencies.

f. **Capital Market Instruments**: The capital market generally consists of the following long term period i.e., more than one year period, financial instruments; In the equity segment Equity shares, preference shares, convertible preference shares, non-convertible preference shares etc and in the debt segment debentures, zero coupon bonds, deep discount bonds etc.

g. **Hybrid Instruments**: Hybrid instruments have both the features of equity and debenture. This kind of instruments is called as hybrid instruments. Examples are convertible debentures, warrants etc.

2. **Explain the challenge and issues of commercial services of banking.** (4)

Ans. **Capital Adequacy Norms:** The Indian banking companies were required to ensure full implementation of Basel II guidelines – the revised capital norms mandated by the Bank for International Settlements (BIS) by March 31, 2009 (Chadrasekar, 2008) and with Basel II norms that came into force in 2009, maintaining adequate capital reserves have become a priority for banks. Basel II mandates Capital to Risk Weighted Assets Ratio (CRAR) of 8%. However, the RBI has stated that Indian banks must have a CRAR of minimum 9%, effective March 31, 2009. Further, the Government of India has stated that public sector banks must have a capital cushion with a CRAR of at least 12%, higher than the threshold of 9% prescribed by the RBI (Anand, 2009). Significantly, the level of capital ratio in the Indian banking system compares quite well with the banking system in many other countries (Leeladhar, 2008). However, although all Indian commercial banks complied with this statutory requirement with a CRAR of more than the stipulated requirement, a few banks had to raise capital from the market through public issues to meet this requirement. 108 7.2.2. Product Innovation As the Indian banks moved gradually towards universal banking and as they positioned themselves as financial service providers, banking business had been redefined (Kohli, 2001). Oke (2007) points out that in view of intense competition in the business environment, the banking sector emphasised on product innovations over service innovations. Thus, product innovation is of utmost importance as competition in the sector has increased tremendously and product boundaries have blurred. Moreover, the distinction between various players in the financial segment is also getting blurred and banks are facing competition from foreign banks, financial institutions, mutual funds, NBFCs, provident funds and pension funds etc. Therefore, to stay ahead in the race,

banks will have to leverage technology for innovative product development including developing sophisticated financial products (Ballabh, 2001). Interestingly the Indian banking market is seeing discontinuous growth driven by new products and services that include opportunities in credit cards, consumer finance and wealth management on the retail side, and in fee-based income and investment banking on the wholesale banking side (Balasubramanian, Kamal, Puri & Sengupta, 2005). And as customers are now insisting on products which suit their individual requirements, banks are forced to opt for product innovation in order to hang on to their precious customers. Moreover, given the demographic shifts resulting from changes in age profile and household income, Indian consumers will increasingly demand enhanced institutional capabilities and service level from banks. Thus, the challenge for Indian banks is on how to assess the needs of their clientele and offer customized products to meet their satisfaction. There are many advantages of providing and developing existing ancillary services and introducing new services by banks like generation of additional income, more staff-customer contact which would help in further product innovation, and creation of a new differentiated market 109 positions through

Application of Information Technology in Service Delivery Process

The decade of 90s has witnessed a sea change in the way banking is done in India and technology has brought in this change in the functioning of the banks (Shastri, 2001). Till 1980s, banks had only one delivery channel which is the branch presence. However, technology has opened up options for various delivery channels. Technology aided products like ATMs, Point of Sale devices, Anywhere Banking, Smart cards, Internet Banking etc., have given the customer to choose his channel of getting catered to his requirements. Apart from customers' privilege, studies show that the profitability of banks increases when services are provided through e-channels like ATMs (Kondo, 2010). However, the implementation and functioning of e-channels or ITeS in the banking sector seem to be relatively smooth in the developed economies (Guraau, 2002) but in developing or transition economies, it may not be so. Thus, the challenge before Indian banks is how to go for 'convergence' of all the delivery channels so as to provide anything, anywhere and through any mode. Along with the change in the way of functioning of the banks, an important issue has started cropping up and it is going to pose certain problems in the near future especially for the public sector banks. The issue is - the extent to which banks would be able to use technology in its service delivery process. Significantly, the new generation banks are backed by Information Technology. Unlike public sector banks, they are yet to acquire banking experience but they are technologically sound and as a result they are in a better position to offer techno-driven services to their customers. The private sector banks as well as foreign banks have embraced technology right from the inception of their operations and therefore, they have adapted themselves to the changes in the technology easily. On the other hand, the middle and top level staffs of public sector 110 banks have vast and rich experience but they may not have sufficient knowledge in the area of IT or may not be familiar with technological tools that can be used in the service delivery process. As technology has become indispensable in banking operations, the challenge for the banks is on how effectively they are able to use technology in banking operations. In other words, as technology ingrains itself in all aspects of a bank's functioning, the challenge before Indian banks at present is on how to exploit the potential for profiting from investments made in technology.

Risk Management

In emerging markets, risk management, has become a greater concern with the modernization of banking sector and financial markets. This is due to the new risks that institutions face with greater exposure to the global banking sector as well as under the new payments systems which demand greater efficiency with quicker transactions, lower levels of fraud and transaction errors (Clacher et al., 2006). Thus, Risk management has become an important area of focus of bank management. Under BASEL I, banks were focused on credit risk and market risk and their risk management strategies were focused on managing these risks individually in isolation. However, BASEL II has brought into focus a large number of risks which banks need to tackle. In fact, BASEL II has highlighted the inter-linkages of a large number of risks like credit risk, liquidity risk, market risk, operational risk etc., with a view to achieve a more comprehensive risk management framework. Therefore, implementation of BASEL II is being increasingly seen as a medium through which banks constantly endeavor to upgrade the risk management systems to address the changing environment. Moreover, BASEL II underlines the need for enterprise-wide risk management system. Therefore, the challenge for banks is on how to opt for risk integration across the entity and for this banks are required to allocate significant resources.

Risk-based Business Segmentation and Use of Technology

In the present day situation, business segmentation based on risk would become necessary for sustenance. There are certain areas of banking business like investment banking, venture capital financing, which carry high risk and for such areas, better techniques and skills and external advice from specialized agencies may be necessary and even banks may also have to set up their own R & D to have independent advice (Pai, 2001). On the other hand, there are business areas that involve low risk and for decision making in such areas, programmed decision making techniques based on computer technology need to be evolved. Thus, risk based business segmentation would help a bank to strengthen their position in the market.

Development of Knowledge and Skills of its Human Resources

For any service organisation, Human Resource Development is the most important need and banks are no exceptions. To meet the challenges of a fast growing knowledge economy, the trust needs to be on Human Resource Development for which the existing training systems of banks need to be revamped. This is felt necessary in order to keep pace with the fast-changing banking environment at home and abroad. It is commonly observed that in public sector banks especially, there are certain rigidities. In matters of recruitment, it has been seen that initially the public sector banks were able to attract the educated manpower but not the specialists. Thus, the focus must shift from generalist orientation of the staff to specialist orientation i.e., recruiting those who have the ability to imbibe and absorb technology (Velayudham, 2002). In the light of this requirements there need to be thorough improvements in the existing practices of recruitment, training and redeployment. Therefore, large investments will have to be made both in Information Technology and Human Resource Development for imparting knowledge and skill 112 which in turn would reduce response time and accelerate credit delivery and decision

making as well as to expand ancillary business (Pai, 2001). Moreover, David C. McClelland attributed India's slow economic development to the lack of people with the need for achievement (Kunnanatt, 2008). Thus, investment on Human Resource is deemed necessary because in competitive sectors like banking, managers need to possess achievement orientation attribute in adequate measures, and those possessing more of this attribute tend to perform well and produce better results for their organisations.

Enhancing Corporate Governance

Banks are special organisations because their managers have a fiduciary duty to (more risk averse) depositors as well as (more risk prone) shareholders and thus a solution to the 'principal-agent problem' aimed at maximizing shareholder value is inappropriate (Mullineux, 2006). Therefore, the good Corporate Governance of banks requires regulation to balance the interests of depositors and taxpayers with those of the shareholders. Moreover, banks are important participants in the payment and settlement system and as such corporate governance is highly relevant for them. Corporate governance has become more relevant for banks since they not only accept and deploy large amount of uncollateralized public funds in fiduciary capacity but also leverage such funds through credit creation. For financial stability, banks need to have sound corporate governance not only in the level of the individual banks, but it is also a critical ingredient at the system level. Effective risk management systems determine the health of the financial system and its ability to survive economic shocks. Research shows that many risk management failures are due to breakdown in corporate governance which arises due to poor management of conflicts of interest, inadequate understanding of key 113 banking risks and poor Board oversight of the mechanisms for risk management and internal audit. Therefore, it can be said that corporate governance is the foundation of effective risk managements in banks and thus the foundation for a sound financial system. Moreover, with privatization move initiated by the Government in Indian economy, there is a gradual dilution in the Government's equity in public sector banks. However, privatization and autonomy never comes free (Gupta, 2001). They entail considerable amount of accountability to the shareholders as well. A sound corporate governance mechanism, involving transparency and accountability of operations, is central to survival in a competitive market. Therefore, banks have to necessarily reorient their systems, procedures and operations in consonance with this. Moreover, it should be noted that the hallmark of good corporate governance at all times cannot be beyond honesty, integrity, values and ethics (Ghosh Ray, 2009).

Customer Relationship Management

Customer Relationship Marketing (CRM) is the latest buzzword and banks are using this tool to acquire new customers, to retain the old customers and to service the existing and new customers. Customer loyalty seems to be a thing of the past and banks as well as other organisations are offering many incentives to enhance customer loyalty. This is because customer loyalty results in positive behaviours which include an increase in repurchase intentions, an increase in repetition sales, an increase in cross sales, a decrease in price sensitivity, a decrease in costs, and an increase in positive word of mouth communications (Varela-Neira, 2010). As such this is one of the challenging areas that banks need to focus.

There are two important aspects of CRM – one, that CRM does not view customers in totality and two, the devising of banking products (Velayudham, 2002). Regarding the first, customers' needs and demands, and business styles vary and therefore, it is necessary to consider segments 114 of customers and build customer profiles to evolve strategies. Moreover, as banking products are intangible, personal selling of products is a must. As regard to the second, once the need of a market segment is recognized, product differentiation becomes important. Thus, in short it implies that evolving products and then looking for customers may not give desired result; rather the products should be evolved based on customers' need and demand. Therefore, in view of the present situation, banks need to activate their otherwise dormant data warehouse to do a purposeful study into the behavioural patterns of the customers, analyze their needs and accordingly develop products to suit their requirements. In this context, data mining has become an important tool for decision making by the bank management. Through data mining, the Executive Information System (EIS), Decision Support System (DSS) have become faster and more accurate (Shastri, 2001). Thus, banks need to be customer-centric in order to acquire and retain customers. And for this, a bank need to appoint Customer Relationship Managers, field-level sales force, help desk, call centres, interactive voice response systems, kiosks, interactive television and email. .

Increasing Profit and Customer Orientation

In a competitive environment, banks are required to work on thin margins and the focus should be on cost minimization. Resource mobilization should be guided by availability of opportunity for fund deployment in a profitable manner (Pai, 2001). Moreover, as customers are the source of business for banks, the activities and strategies of the banks should be customer-centric. Marketing should receive a major thrust and customized products should be developed to meet customers' expectations. Again liberalization policy of the Government for the banking sector has given wide scope and opportunities. Introduction of ITeS services like EFT, NEFT, RTGS etc. have reduced administrative costs, increased 115 efficiency, simplified book-keeping, and enhanced security for customer payments. Significantly, banks can make use of the ITeS infrastructure for introducing new payment/ cash management products. The focus should be to increase the avenues for income by providing various innovative and customised products.

Need for Branch Rationalisation

Banks, in order to reduce its administrative costs, need to rationalise the branch networking by consolidating the number of branches within a local area into a single profit centre without affecting customer service. Moreover, at the industry level, strategic alliances and mergers of even healthy banks would also become necessary (Pai, 2001). 7.2.11. Need for Greater Prudence Future banking has to be based on prudence. New bloods with new skills are to be inducted to face the coming challenges. Business will have to be organised on more commercial lines with focus on income and profit centres and on Information Technology. Prudent policies for provisioning have to be adopted apart from norms laid down by the RBI for investments and credit.

Asset Liability Management

All commercial banks should give utmost importance to Asset Liability Management from the view point of liquidity as well as interest rate sensitivity. In fact, an effective Asset Liability Management technique aims to manage the volume, mix, maturity, rate sensitivity, quality and liquidity of assets and liabilities as a whole so as to attain a predetermined acceptable risk/ reward ratio (Kumar et al., 2005). Thus, the purpose of ALM is to enhance the asset quality; quantify risks associated with the assets and liabilities and further manage them. Asset Liability Management is deemed necessary because asset-liability mismatches expose the banks 116 to various types of risks i.e., risks of illiquidity and insolvency; risks arising from globalisation and deregulation. In the context of the Indian economy getting integrated with that of international economy and the banking system getting exposed to more and more doses of transparency, Asset Liability Management Committee (ALCO) of the individual banks should practically customise and parameterise their approaches and actions and strike a balance between risk and reward (Murthy, 2001).

Brand Building and Management

It takes years to build a brand. A brand is a name, term, sign, symbol or design or a combination of these intended to identify the goods or services of one seller or a group of sellers and to differentiate them from those of competitors (Kotler & Armstrong, 1997). Brand building has become a major issue in product strategy. Therefore, marketing and image research studies should be given the same attention as the monthly financial figures and should be treated with the same respect and should feed into strategic decision making (Worcester, 1997). As banks offer a variety of services under an umbrella brand, building a brand and managing it has become a challenge. Banks should focus on building a powerful brand that has high brand equity. This is because a brand with high brand equity implies that they have higher brand loyalty, name awareness, perceived quality and strong brand associations. Therefore, huge investment of resources – both monetary and time – is required to build a brand and for its management.

3. **Explain traditional and promotional function of RBI.** (4)

Ans. **Traditional Functions:** The RBI functions on the traditional lines regarding the following activities:

- **Monopoly of Note Issue:** In terms of Section 22 of the Reserve Bank of India Act, the RBI has been given the statutory function of note issue on a monopoly basis. The note issue in India was originally based upon "Proportional Reserve System".

  When it became difficult to maintain the reserve proportionately, it was replaced by "Minimum Reserve System ". According to the RBI Amendment Act of 1957, the bank should now maintain a minimum reserve of Rs.200 crore worth of gold coins, gold bullion and foreign securities of which the value of gold coin and bullion should be not less than Rs.115 crore.

The Government of India issues rupee coins in the denomination of Rs.1, 2, and 5 topublic. These coins are required to be circulated to public only through Reserve Bank under Section 38 of the RBI Act. The RBI presently issues notes of denominations Rs.10 and above.

RBI manages circulation of money through currency chests. Originally RBI issued currency notes of Rs.2 and above. However, due to higher cost of printing small denomination notes these denominations are now coincides and issued by Government.

The value of currency with public as on June 1991 was only to the extent of Rs.53048 crore. However, this value went up to Rs.145182 crore in June 1998 and further to Rs.169382 crore in March, 1999.

Currency Chests Currency Chests are receptacles in which stocks of issuable and new notes are stored along with rupee coins. Currency Chests are repositories run by RBI, SBI, subsidiaries of SBI, public sector banks, Government Treasuries and Sub treasuries.

Currency Chests help in expansion and contraction of currency in the country. The advantages for a bank having currency chest are:

- The bank can draw funds whenever it is required for its use and deposit funds when found surplus.
- Exchange old and mutilated notes for new notes and coins.
- Enjoy remittance facilities.
- Cash remitted to currency chests by banks can be taken into account for maintenance of CRR.

The currency chests maintained by public sector and few private sector banks are the property of RBI. The value of currency held in the chest belongs to RBI. There are as many as 4150 currency chests with banks in India.

- **Banker to the Government:** The RBI acts as banker to the Government under Section 20 of RBI Act. Section 21 provides that Government should entrust its money remittance, exchange and banking transactions in India to RBI. Under Section 21A RBI has to conduct similar transactions for State Governments also.

  RBI earns no income by conducting those functions but earns commissions for managing the government's public debt. Where RBI has no branch, SBI or its subsidiaries are appointed as agents and sub-agents under Section 45 of the RBI Act. Agency Banks receive commission on all transactions conducted on turnover basis.

  The RBI extends ' ways and means ' advances to Central and State Governments.

Ways and Means Advances:

"Ways and Means Advances" (WMA) is not a commercial bank credit. It is a system under which the RBI provides credit to Central and State Governments for meeting temporary shortfall in government revenues as compared to the monthly expenditures.

In other words, this facility is provided to meet temporary mismatches between revenue collections and revenue expenditures of governments. The maximum volume and period of such advances are governed by agreements between RBI and the concerned government. To the State Governments, this facility is extended under three categories known as:

- Normal WMA
- Special WMA and
- as an overdraft facility.

It also acts as adviser to Government on economic and financial matters. In brief, as a banker to the Government the RBI renders the following functions:

- Collects taxes and makes payments on behalf of the Government
- Accepts deposits from the Government
- Collects cheques and drafts deposited in the Government accounts.
- Provides short-term loans to the Government
- Provides foreign exchange resources to the Government.
- Keep the accounts of various Government Department.
- Maintains currency chests in treasuries at some importance places for the convenience of the government.
- Advises governments on their borrowing programmes.
- Maintains and operates Central Government's IMF accounts.

- **Agent and Adviser of the Government**: The RBI acts, as the financial agent and adviser to the Government. It renders the following functions:
    - As an agent to the Government, it accepts loans and manages public debts on behalf of the Government.
    - It issues Government bonds, treasury bills, etc.
    - Acts as the financial adviser to the Government in all important economic and financial matters.

- **Banker to the Banks:** The RBI acts as banker to all scheduled banks. Commercial banks including foreign banks, co-operative banks and RRBs are eligible to be included in the second schedule of RBI Act subject to fulfilling conditions laid down under Section 42 (6) of RBI Act.

  RBI has powers to delete a bank from the second schedule if the bank concerned fails to fulfill the laid down conditions such as erosion in paid up capital below the prescribed limits and the banks' activities became detrimental to the interest of depositors, etc.

  All banks in India, should keep certain percentage of their demand and time liabilities as reserves with the RBI. This is known as Cash Reserve Ratio or CRR. At end November 1999, it is 3 per cent for RRBs and co-operative banks; 9 per cent for commercial banks.

They also maintain Current Account with RBI for various banking transactions. This centralization of reserves and accounts enables the RBI to achieve the following:

- Regulation of money supply credit.
- Acts as custodian of cash reserves of commercial banks.
- Strengthen the banking system of the country
- Exercises effective control over banks in Liquidity Management.
- Ensures timely financial assistance to the Banks in difficulties.
- Gives directions to the Banks in their lending policies in the public interest.
- Ensures elasticity in the credit structure of the country.
- Quick transfer of funds between member banks.

- **Acts as National Clearing House:** In India RBI acts as the clearing house for settlement of banking transactions. This function of clearing house enables the other banks to settle their interbank claims easily. Further it facilitates the settlement economically.

  Where the RBI has no offices of its own, the function of clearing house is carried out in the premises of the State Bank of India. The entire clearing house operations carried on by RBI are computerized. The inter-bank cheque clearing settlement is done twice a day.

  There is a separate route for clearing high value cheques of Rs.1.00 lakh and above. Cheques drawn on banks in metropolitan cities are cleared on the same day.

  The RBI carries out this function through a cell known as National Clearing Cell. In 1998, there were in all 860 clearing houses in operation of which 14 were run by RBI, 578 by SBI and others by public sector banks.

  The RBI acts as a lender of last resort or emergency fund provider to the other member banks. As such, if the commercial banks are not able to get financial assistance from any other sources, then as a last resort, they can approach the RBI for the necessary financial assistance.

  In such situations, the RBI provides credit facilities to the commercial banks on eligible securities including genuine trade bills which are usually made available at Bank Rate.

  RBI rediscounts bills under Section 17 (2) and 17 (3) and grants advances against securities under Section 17 (4) of RBI Act. However, many of these transactions are practically carried out through separate agencies like DHFI, Securities Trading Corporation of India, primary dealers.

  The RBI now mainly provides refinance facilities as direct assistance. Rediscounting of bills fall under the following categories:

a. **Commercial Bill:** A bill arising out of bonfire commercial or trade transaction drawn and payable in India and mature within 90 days from the date of purchase or discount is eligible for rediscount.

b. **Bills for Financing Agricultural Operations:** A bill issued for purpose of financing seasonal agricultural operations or the marketing of crops and maturing within 15 months from the date of purchase or rediscount.

c. **Bills for Financing Cottage and Small Scale Industries:** Bills drawn or issued for the purpose of financing the production and marketing of products of cottage and small industries approved by RBI and mature within 12 months from the date of discount.

   Refinance under agricultural and small scale industries activities are now provided by NABARD by obtaining financial assistance from RBI. Bill for holding or trading in Government securities: Such a bill should mature within 90 days from the date of purchase or rediscounting and be drawn and payable in India,

d. **Foreign bills:** Bonfire bill arising out of export of goods from India and which mature within 180 days from the date of shipment of goods are eligible. As lender of last resort the RBI facilitates the following:
   - Provides financial assistance to commercial banks at the time of financial needs.
   - It helps the commercial banks in maintaining liquidity of their financial resources.
   - Enables the commercial banks to carry out their activities with minimum cash reserves.
   - As a lender of last resort, the RBI can exercise full control over the commercial banks.

- **Acts as the Controller of Credit:** The RBI controls the credit creation by commercial banks. For this, the RBI uses both quantitative and qualitative methods. The important methods used by RBI are:
  - Bank Rate Policy
  - Open Market Operation
  - Variation of Cash Reserve Ratio
  - Fixing Margin Requirements
  - Moral Suasion
  - Issue of Directives
  - Direct Action

  By controlling credit, the RBI achieves the following:
  - Maintains the desired level of circulation of money in the economy.
  - Maintains the stability in the price level prevailing in the economy.
  - Controls the effects of trade cycles

- Controls the fluctuations in the foreign exchange rate
- Channelize credit to the productive sectors of the economy

- **Custodian of Foreign Exchange Reserves**: The RBI acts as the custodian of foreign exchange reserves. Adequate reserves may help maintain foreign exchange rates. In order to minimize the undue fluctuations in the rates it may buy and sell foreign currencies depending upon the situations.

  Its purchase and sale of foreign currencies from the market is done like commercial banks. However, the objective of the RBI will not be profit booking.

  It may buy the foreign currency to build up adequate reserves or to arrest unwarranted rise in the value of rupee which may be due to sudden inflow of foreign currencies into India. It may also buy and sell foreign currencies in international market to switch the portfolio of investments denominated in different international currencies depending upon circumstances and needs.

  The value of India's Foreign Exchange reserves held by RBI as on June 1998 amounted to Rs.115001 crore. This amount comprises of gold Rs.12826 crore, foreign currency assets and value of IMF currency, viz., SDR (Special Drawing Rights).

  These reserves are increased to Rs. 1, 38,005 crore in March 1999. The value of foreign currency assets of RBI, which form the largest portion in India's Foreign Currency reserves, is subject to changes even on daily basis depending upon ruling exchange rates, inflow and outflow of currencies, intervention policy of the RBI, etc.

- **Exchange Control**: When a country faces Balance of Payment of problems usually when its foreign exchange payments exceed foreign exchange receipts it controls the whole gamut of fore (foreign exchange) transactions and regulates payment system for its advantage.

  Ever since the beginning of Second World War in 1939 India faced shortage of forex for its development and growth. A Foreign Exchange Regulation Act was originally put in operation from March 1947 and later a new act known as Foreign Exchange Regulation Act (FERA) 1973 was introduced from 1st January 1974.

  Under this Act, RBI is empowered to regulate foreign exchange outgo and inflow, for example, we cannot buy everything we need from abroad and pay for it in forex.

  Trade side imports, i.e., merchandise imports are regulated by Director General Foreign Trade in the Ministry of Commerce. Payment for invisible transactions like tourism, foreign visit, dividend/interest payment, etc. is regulated by RBI.

  Similarly, all forex received or earned by residents in India, like exporters and relatives of NRIs [Non-resident Indian] should be surrendered to banks having license from RBI

to deal in forex. However, since 1992, the receivers of forex are permitted to retain certain part of this forex in a separate foreign currency account if they so desire. Such account is known as Exchange Earners' Foreign Currency Account or EEFC Account.

Further, since 1994 many controls exercised by RBI on forex payments were relaxed. These days the RBI regulates forex transactions only to a minimum level and soon the Act, FERA may be replaced by a new Foreign Exchange Management Act.

While the purchase and sale of forex, maintenance of foreign exchange reserves/gold, are handled in the Department of External Investment and operations the control and regulations of various other forex transactions are handled in the Exchange Control Department of Reserve Bank of India.

The RBI by its operation of credit control and price stability maintains the internal value of domestic currency and ensures its stability.

Promotional Functions

These are non-monetary functions. They include the following:

- **Promotion of Banking Habits**: The RBI institutionalizes saving through the promotion of banking habit and expansion of the banking system territorially and functionally.

  Accordingly RBI has set up Deposit Insurance Corporation in 1962, Unit Trust of India in 1964, the IDBI in 1964, the Agricultural Refinance Corporation in 1963, Industrial Reconstruction Corporation of India in 1972, NABARD in 1982 and the National Housing Bank in 1988, etc.

  It has helped to bring into existence several industrial finance corporations such as Industrial Finance Corporation of India, Industrial Credit and Investment Corporation of India for industrialization of the country. Similarly sector specific corporations took care of development in their respective spheres of activity.

- **Provides Refinance for Export Promotion:** The RBI takes the initiative for widening facilities for the provision of finance for foreign trade particularly of exports.

  The Export Credit and Guarantee Corporation (ECGC) and Exam Banks render useful functions on this line. To encourage exports the RBI is providing refinance facilities for export credit given by commercial banks. Further the rate of interest on export credits continues to be prescribed by RBI at a lower rate.

  The ECGC provides an insurance cover on Export receivables. EXIM Bank extends long term finance to project exporters and foreign currency credit for

promotion of Indian exports. Students should know that many of these institutions were part of Reserve Bank earlier although they are currently functioning as separate financial institutions.

- **Facilities for Agriculture**: The RBI extends indirect financial facilities to agriculture regularly. Through NABARD it provides short-term and long-term financial facilities to agriculture and allied activities. It established NABARD for the overall administration of agricultural and rural credit. Indian agriculture would have starved of a cheap credit but for the institutionalization of rural credit by RBI.

  The Reserve Bank was extending financial assistance to the rural sector mainly through contributions to the National Rural Credit Funds being operated by NABARD. RBI presently makes only a symbolic contribution of Rs.1.00 crore.

  It, however, extends cheap indirect financial assistance to the agricultural sector by providing large sums of money through General Line of Credit to NABARD. The loans and advances extended to NABARD by RBI and outstanding as on June 1999 amounted to Rs.5073 crore.

- **Facilities to Small Scale Industries:** The RBI takes active steps to increase the supply of credit to small industries. It gives directives to the commercial banks regarding the extension of credit facilities to small scale industries. It encourages commercial banks to provide guarantee services to SSI sector. Banks advances to SSI sector are classified under priority sector advances.

  SSI sector contributes to a very great extent to employment opportunities and for Indian Exports. Keeping this in view, RBI has directed commercial banks to open specialized SSI bank branches to provide adequate financial and technical assistance to SSI branches. There are around 30 lakh SSI units operating in India. Meeting their financial needs is one of the prime concerns of RBI.

- **Helps Co-operative Sector**: RBI extends indirect financing to State Co-operative Banks thereby connects the cooperative sector with the main banking system of the country. The finance is mostly, is routed through NABARD. This way the financial needs of agricultural sector are taken care of by RBI.

- **Prescription of Minimum Statutory Requirements for Banks**: The RBI prescribes the minimum statutory requirements such as, paid up capital, reserves, cash reserves, liquid assets, etc. RBI prescribes reserves requirements both under Banking Regulation Act and RBI Act to ensure different objectives.

For example, SLR prescription is done to ensure liquidity position of the bank. CRR prescription is done to have effective monetary control and money supply. Statutory Reserves Appropriation is done to ensure sound banking system, etc.

It also asks banks to set aside provisions against possible bad loans. With these functions, it exercises control over the monetary and banking systems of the country to ensure growth, price stability and sound banking practices.

4. **Write short notes on:** (3)
   a. **Commercial paper**
   b. **Certificate of deposits**

Ans. A. **Commercial paper:** Commercial Paper (CP) is yet another money market instrument in India, which was first introduced in 1990 to enable the highly rated corporates to diversify their resources for short term fund requirements. They are issued either in the form of a promissory note or in a dematerialised form through any of the depositories approved by and registered with SEBI. They are essentially unsecured debt instruments.

Who is eligible to issue commercial papers?

Corporate, Primary Dealers and All India Financial Institutions are eligible to issue CP. To be eligible to issue Commercial Paper, the Corporate need to have a tangible net worth of minimum Rs. 4 Crore. Further,

- the company must have been sanctioned working capital limit by banks or all-India financial institutions.
- The borrower account of the company should be high rated i.e. it should be classified as Standard Asset by the Financial Institutions.

Further, the Corporate, Primary Dealers as well as Financial Institutions must obtain the credit rating for issuance of Commercial Paper either from Credit Rating Information Services of India Ltd. (CRISIL) or the Investment Information and Credit Rating Agency of India Ltd. (ICRA) or the Credit Analysis and Research Ltd. (CARE) or the FITCH Ratings India Pvt. Ltd. or such other credit rating agency (CRA) as may be specified by the Reserve Bank of India from time to time, for the purpose.

Denominations and Maturity of Commercial Paper

Maturity of Commercial Paper is minimum of 7 days and a maximum of up to one year from the date of issue. CP can be issued in denominations of Rs.5 lakh or multiples thereof.

Who can Invest in CP?

Individuals, banking companies, other corporate bodies (registered or incorporated in India) and unincorporated bodies, Non-Resident Indians (NRIs) and Foreign Institutional Investors (FIIs) etc. can invest in CPs. However, investment by FIIs would be within the limits set for them by Securities and Exchange Board of India (SEBI) from time-to-time.

What is return on CP?

CP is issued at a discount to face value as may be determined by the issuer. The difference between issue price and face value is return. Further, CPs are traded in the OTC markets.

B. **Certificate of Deposit (CD):**

- **Introduction:** Certificate of Deposit (CD) is a negotiable money market instrument and issued in dematerialised form or as a Usance Promissory Note against funds deposited at a bank or other eligible financial institution for a specified time period. Guidelines for issue of CDs are presently governed by various directives issued by the Reserve Bank of India (RBI), as amended from time to time. The guidelines for issue of CDs, incorporating all the amendments issued till date, are given below for ready reference.

- **Eligibility:** CDs can be issued by (i) scheduled commercial banks {excluding Regional Rural Banks and Local Area Banks}; and (ii) select All-India Financial Institutions (FIs) that have been permitted by RBI to raise short-term resources within the umbrella limit fixed by RBI.

- **Aggregate Amount:**
  - Banks have the freedom to issue CDs depending on their funding requirements.
  - An FI can issue CD within the overall umbrella limit prescribed in the Master Circular on Resource Raising Norms for FIs, issued by DBOD and updated from time-to-time.

- **Minimum Size of Issue and Denominations:** Minimum amount of a CD should be Rs.1 lakh, i.e., the minimum deposit that could be accepted from a single subscriber should not be less than Rs.1 lakh, and in multiples of Rs. 1 lakh thereafter.

- **Investors:** CDs can be issued to individuals, corporations, companies (including banks and PDs), trusts, funds, associations, etc. Non-Resident Indians (NRIs) may also subscribe to CDs, but only on non-repatriable basis, which should be clearly stated on the Certificate. Such CDs cannot be endorsed to another NRI in the secondary market.

- **Maturity:**
  - The maturity period of CDs issued by banks should not be less than 7 days and not more than one year, from the date of issue.
  - The FIs can issue CDs for a period not less than 1 year and not exceeding 3 years from the date of issue.

- **Discount / Coupon Rate:** CDs may be issued at a discount on face value. Banks / FIs are also allowed to issue CDs on floating rate basis provided the methodology of compiling the floating rate is objective, transparent and market-based. The issuing bank / FI is free to determine the discount / coupon rate. The interest rate on floating rate CDs would have to be reset periodically in accordance with a pre-determined formula that

indicates the spread over a transparent benchmark. The investor should be clearly informed of the same.

- **Reserve Requirements:** Banks have to maintain appropriate reserve requirements, i.e., cash reserve ratio (CRR) and statutory liquidity ratio (SLR), on the issue price of the CDs.

- **Transferability**: CDs in physical form are freely transferable by endorsement and delivery. CDs in demat form can be transferred as per the procedure applicable to other demat securities. There is no lock-in period for the CDs.

- **Trades in CDs:** All OTC trades in CDs shall be reported within 15 minutes of the trade on the FIMMDA reporting platform.

- **Settlement:** All OTC trades in CDs shall necessarily be cleared and settled under DVP I mechanism through the authorised clearing houses {National Securities Clearing Corporation Limited (NSCCL), Indian Clearing Corporation Limited (ICCL) and MCX Stock Exchange Clearing Corporation Limited (CCL)} of the stock exchanges.

- **Loans / Buy-backs:** Banks / FIs cannot grant loans against CDs. Furthermore, they cannot buy-back their own CDs before maturity. However, the RBI may relax these restrictions for temporary periods through a separate notification.

- **Format of CDs:** Banks / FIs should issue CDs only in dematerialised form. However, according to the Depositories Act, 1996, investors have the option to seek certificate in physical form. Accordingly, if an investor insists on physical certificate, the bank / FI may inform the Chief General Manager, Financial Markets Department, Reserve Bank of India, Central Office, Fort, Mumbai - 400 001 about such instances separately. Further, issuance of CDs will attract stamp duty. A format (**Annex I**) is enclosed for adoption by banks / FIs. There will be no grace period for repayment of CDs. If the maturity date happens to be a holiday, the issuing bank/FI should make payment on the immediate preceding working day. Banks / FIs, therefore, should fix the period of deposit in such a manner that the maturity date does not coincide with a holiday to avoid loss of discount / interest rate.

- **Security Aspect:** Since CDs in physical form are freely transferable by endorsement and delivery, it will be necessary for banks/FIs to see that the certificates are printed on good quality security paper and necessary precautions are taken to guard against tampering with the document. They should be signed by two or more authorised signatories.

- **Payment of Certificate:** Since CDs are transferable, the physical certificates may be presented for payment by the last holder. The question of liability on account of any defect in the chain of endorsements may arise. It is, therefore, desirable that banks take necessary precautions and make payment only by a crossed cheque. Those who deal in these CDs may also be suitably cautioned.

The holders of dematted CDs will approach their respective depository participants (DPs) and give transfer / delivery instructions to transfer the security represented by the specific International Securities Identification Number (ISIN) to the 'CD Redemption Account' maintained by the issuer. The holders should also communicate to the issuer by a letter / fax enclosing the copy of the delivery instruction they had given to their respective DP and intimate the place at which the payment is requested to facilitate prompt payment. Upon receipt of the demat credit of CDs in the "CD Redemption Account", the issuer, on maturity date, would arrange to repay to holders / transferors by way of Banker's cheque / high value cheque, etc.

- **Issue of Duplicate Certificates:** In case of loss of physical certificates, duplicate certificates can be issued after compliance with the following:
  - Notice is required to be given in at least one local newspaper;
  - Lapse of a reasonable period (say 15 days) from the date of the notice in the newspaper; and
  - Execution of an indemnity bond by the investor to the satisfaction of the issuer of CDs.

  The duplicate certificate should be issued only in physical form. No fresh stamping is required as a duplicate certificate is issued against the original lost CD. The duplicate CD should clearly state that the CD is a Duplicate one stating the original value date, due date, and the date of issue (as "Duplicate issued on ________").

- **Accounting:** Banks / FIs may account the issue price under the Head "CDs issued" and show it under deposits. Accounting entries towards discount will be made as in the case of "Cash Certificates". Banks / FIs should maintain a register of CDs issued with complete particulars.

- **Standardised Market Practices and Documentation:** Fixed Income Money Market and Derivatives Association of India (FIMMDA) may prescribe, in consultation with the RBI, for operational flexibility and smooth functioning of the CD market, any standardised procedure and documentation that are to be followed by the participants, in consonance with the international best practices. Banks / FIs may refer to the detailed guidelines issued by FIMMDA in this regard on June 20, 2002 and as amended from time to time (http://fimmda.org).

5. **Explain the functions of Merchant Banking?** (4)

Ans. The functions of Merchant Banking are:

- **Corporate counseling:** Corporate counseling covers counseling in the form of project counseling, capital restructuring, project management, public issue management, loan syndication, working capital fixed deposit, lease financing, acceptance credit etc., The scope of corporate counseling is limited to giving suggestions and opinions to the client and help taking actions to solve their

problems. It is provided to a corporate unit with a view to ensure better performance, maintain steady growth and create better image among investors.

- **Project counseling** Project counseling is a part of corporate counseling and relates to project finance. It broadly covers the study of the project, offering advisory assistance on the viability and procedural steps for its implementation.
  - Identification of potential investment avenues.
  - A general view of the project ideas or project profiles.
  - Advising on procedural aspects of project implementation
  - Reviewing the technical feasibility of the project
  - Assisting in the(Technical selection Consultancy Organizations) of for TCO preparing project reports
  - Assisting in the preparation of project report
  - Assisting in obtaining approvals, licenses, grants, foreign collaboration etc., from government
  - Capital structuring
  - Arranging and negotiating foreign collaborations, amalgamations, mergers and takeovers.
  - Assisting clients in preparing applications for financial assistance to various national and state level institutions banks etc.,
  - Providing assistance to entrepreneurs coming to India in seeking approvals from the Government of India.

- **Capital Structure:** Here the Capital Structure is worked out i.e., the capital required, raising of the capital, debt-equity ratio, issue of shares and debentures, working capital, fixed capital requirements, etc.

- **Portfolio Management:** It refers to the effective management of Securities i.e., the merchant banker helps the investor in matters pertaining to investment decisions. Taxation and inflation are taken into account while advising on investment in different securities. The merchant banker also undertakes the function of buying and selling of securities on behalf of their client companies. Investments are done in such a way that it ensures maximum returns and minimum risks.

- **Issue Management:** Management of issues refers to effective marketing of corporate securities viz., equity shares, preference shares and debentures or bonds by offering them to public. Merchant banks act as intermediary whose main job is to transfer capital from those who own it to those who need it. The issue function may be broadly divided in to pre issue and post issue management.
  - Issue through prospectus, offer for sale and private placement.
  - Marketing and underwriting
  - Pricing of issues

- **Credit Syndication:** Credit Syndication refers to obtaining of loans from single development finance institution or a syndicate or consortium. Merchant Banks

help corporate clients to raise syndicated loans from commercials banks. Merchant banks helps in identifying which financial institution should be approached for term loans. The merchant bankers follow certain steps before assisting the clients approach the appropriate financial institutions.

Merchant banker first makes an appraisal of the project to satisfy that it is viable b. He ensures that the project adheres to the guidelines for financing industrial projects. c. It helps in designing capital structure, determining the promoter_s amount of term loan to be raised. d. After verifications of the project, the Merchant Banker arranges for a preliminary meeting with financial institution. e. If the financial institution agrees to consider the proposal, the application is filled and submitted along with other documents.

- **Working Capital:** The Companies are given Working Capital finance, depending upon their earning capacities in relation to the interest rate prevailing in the market.

- **Venture Capital:** Venture Capital is a kind of capital requirement which carries more risks and hence only few institutions come forward to finance. The merchant banker looks in to the technical competency of the entrepreneur for venture capital finance.

- **Fixed Deposit:** Merchant bankers assist the companies to raise finance by way of fixed deposits from the public. However such companies should fulfill credit rating requirements.

- **Other Functions:**
  - **Treasury Management**- Management of short term fund requirements by client companies.
  - **Stock broking**- helping the investors through a network of service units.
  - **Servicing of issues**- servicing the shareholders and debenture holders in distributing dividends, debenture interest.
  - **Small Scale industry counseling**- counseling SSI units on marketing and finance.
  - **Equity research and investment counseling** –merchant banker plays an important role in providing equity research and investment counseling because the investor is not in a position to take appropriate investment decision.
  - **Assistance to NRI investors** - the NRI investors are brought to the notice of the various investment opportunities in the country.
  - **Foreign Collaboration**: Foreign collaboration arrangements are made by the Merchant bankers.

6. **Differentiate between Lease And Hire Purchase.** (3)

Ans. **Difference between lease and hire purchase are:**

- **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 installment 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, installment 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 20 to 25 % 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 analyzed properly as to how much the option suits to the business requirement and situations.

7. **Explain IRDA in detail.** (4)

Ans. The IRDA Act, 1999 was passed as per the major recommendation of the Malhotra Committee report (1994) which recommended the establishment of an independent regulatory authority for insurance sector in India. Later, it was incorporated as a statutory body in April, 2000. The IRDA Act, 1999 also allows private players to enter the insurance sector in India besides a maximum foreign equity of 26 per cent in a private insurance company having operations in India. Considering some of the emerging requirements of the Indian insurance industry, IRDA was amended in 2002. As stated in the act mission of IRDA is "to protect the interests of the policyholders, to regulate, promote and ensure orderly growth of the insurance

industry and for matters connected therewith or incidental thereto." Indian insurance industry is regulated by the terms and conditions of the IRDA. Indian law has certain expectations from the IRDA to perform in the Indian insurance industry. IRDA should protect the interest of policyholders by ensuring fair treatment by the insurance companies. The growth of insurance companies in a speedy and orderly manner should be taken care by the IRDA. It should monitor and implement quality competence and fair dealing of the insurance companies in the industry. IRDA should make sure that the insurers are providing precise and correct information about the products offered by them for the insurance customers. IRDA should also ensure speedy settlement of genuine claims of the policyholders and prevent malpractices in the process of claims settlement. IRDA controls all the Insurance business in India. They are setting structure and boundaries for the insurance companies to act upon. Starting from licensing to approving the products, IRDA directs the companies in India. They also protect customer interests in the country. As per current guidelines issued by IRDA, Insurance Companies are not permitted to invest in Indian Depository Receipts (IDR), while they are permitted to invest in Equity shares/ Bonds/ Debentures. IRDA needs to remove this disparity to open up investment opportunity by Insurance Companies and thereby also enhance the liquidity of IDRs (Contributed by Sanjay Banka, FCA FCS) Hence, the present work made an attempt to study the Role of IRDA in Indian Insurance sector.

Functions of Insurance Regulatory and Development Authority: The Insurance Regulatory and Development Authority (IRDA) is a national apex regulatory agency of the Government of India. It performs the following functions with respect to the insurance sector in India.

- It issues the certificate of registration or renewal to Insurance companies, insurance agents or surveyors, Insurance brokers. To function in the insurance sector, a company has to register with the IRDA.
- IRDA Protects the interests of the policyholders in matters like, nomination by policyholders, assigning of the policy, insurable interest, surrender values of the policy, settlement of insurance claim, and various other terms involved in the conditions of contracts of insurance.
- It specifies the requisite qualification, practical training, and code of conduct for agents, insurance brokers, and surveyors.
- IRDA is involved in promoting efficiency in insurance business conduction.
- It promotes and regulates professional organisations that connect with the insurance and re-insurance business.
- IRDA also specifies the code of conduct for surveyors and loss assessors.
- It regulates the fees and other similar charges levied by the insurance companies, brokers, agents, surveyors, etc.
- IRDA controls the rates, advantages, and terms and conditions which are offered by the insurers.
- It specifies the form and manner in which books of accounts are to be maintained by the insurers and other insurance intermediateries.
- It regulates the investment of funds made by the insurance companies and firms.
- IRDA settles disputes between insurers and intermediateries, whenever they arise.
- It also regulates the maintenance of margin of solvency(To possess sufficient funds to settle insurance claim amounts).

- It specifies the percentage of premium income of the insurer that can go to finance schemes for promotion and regulation of professional organisations.
- It also specifies the percentage of life insurance business and general insurance business that can be undertaken by the insurer in the social and rural sector.
- It supervises the working of the Tariff Advisory Committee also.
- IRDA has the power to frame regulations regarding the Insurance market.
- It promotes competition among the insurance companies and insurers in order to enhance customer satisfaction, by providing increased choice to consumers. Like it allowed Health Insurance Portability.
- IRDA is also involved in the field of Consumer education and assistance.

8. **Explain the advantage and disadvantage of plastic money.** (4)

Ans. **Advantages of Plastic Money:** There are several advantages of plastic money as seen in the above illustration. The advantages include:

- **Eliminates the need for carrying huge cash:** This eliminates the need for carrying huge load of cash which is risky and inconvenient too.
- **Risk of Loss or Theft minimized:** In case of cash there is a high risk of losing cash and a chance of cash getting stolen. However, in case of debit/credit card you can report the matter to the bank and block the card to avoid misuse.
- **Anytime/Anywhere Access:** Using cards you have the unique advantage and convenience of using it anywhere in the country or even abroad.
- **Credit Facility:** In case of credit card you have the option of buying on credit or paying later. Although the charges are high, it helps you in case of emergencies and contingencies.
- **Online Payments:** You can use cards for online payments, fund transfers and various other transactions.

These are the key benefits which I can easily remember, but there could be various other good features too that are specific to certain cards.

Disadvantages of Plastic Money:

- Cards/plastic money is not a complete replacement for cash.
- Use of cards can also be risky in some cases.