**Rajasthan Institute of Engineering & Technology, Jaipur**

**University Roll No. \_\_\_\_\_\_\_\_\_\_\_\_\_\_**

2nd Year MBA 3rd Semester I Mid Term Examination, October – 2018

Subject: - MFS SET-A

Time: - 2 Hrs. [Maximum Marks: -20]

[Min. Passing Marks: 08]

Instructions to the Candidates:

Attempt any 4 questions from Section A and Section B is Compulsory.

**Section A**

1. Elaborate Indian financial system in detail. (3)

Ans- The formal financial system consists of four **components**:

1. Financial institutions,
2. Financial markets,
3. Financial instruments and
4. Financial services.

The financial system acts as a connecting link between savers of money and users of money and thereby promotes faster economic and industrial growth.

Thus financial system may be defined as “a set of markets and institutions to facilitate the exchange of assets and risks.”

Efficient functioning of the financial system enables proper flow of funds from investors to productive activities which in turn facilitates investment.

### Classification of Financial Market in India:

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**Capital Market**

1. Corporate Market

* Primary Market
* Secondary Market

2. Government Securities Markets

3. Long Term Loans Markets

* Term Loan Markets
* Mortgages Markets
* Financial Guarantees Markets

**Money Market**

1. Unorganized Market

* Money Lenders
* Indigenous Bankers
* Chit Funds

2. Organized Money Market

* Treasury Bills
* Commercial Paper (CP)
* Certificate Of Deposit (CD) etc.
* Call Money Market
* Commercial Bill Market

[**Capital Market**](http://articles-junction.blogspot.com/2013/09/methods-of-raising-funds-from-capital.html)

A capital market is an organized market. It provides long term finance for business. According to Shri, K.S. “Capital Market refers to the facilities and institutional arrangements for borrowing and lending long-term funds.”

1. **What do you meant by investment banking? Define its objectives.**  (3)

Ans- An investment bank is typically a private company that provides various financial-related and other services to individuals, corporations, and governments such as raising financial capital by underwriting or acting as the client's agent in the issuance of securities.

Investment banking is a specific division of banking related to the creation of [capital](http://www.investopedia.com/terms/c/capital.asp) for other companies, governments and other entities. Investment banks underwrite new [debt](http://www.investopedia.com/terms/d/debtsecurity.asp) and equity [securities](http://www.investopedia.com/terms/s/security.asp) for all types of [corporations](http://www.investopedia.com/terms/c/corporation.asp), aid in the sale of securities, and help to facilitate [mergers and acquisitions](http://www.investopedia.com/terms/m/mergersandacquisitions.asp), [reorganizations](http://www.investopedia.com/terms/r/reorganization.asp) and broker trades for both institutions and private investors. Investment banks also provide guidance to issuers regarding the issue and placement of [stock](http://www.investopedia.com/terms/s/stock.asp).

Investment bank offer following financial services for clients-

* The trading of derivatives
* Fixed income
* Foreign exchange,
* Commodity and Equities or advisory services for mergers and acquisitions.
* Investment banks perform, Initial Public offerings (IPO), trades on securities and bonds and they also act as brokers

**Functions Of Investment Bankers-**

The traditional function of the investment bankers has been to act as middlemen in channeling individual's savings and funds into the purchase of business securities. But now a days, they also provide advice and help in distribution of securities. Thus, investment bankers perform four basic functions as follows:

**1. Underwriting**

When underwriting a security issue, an investment banker guarantees the issuer that it will receive a specific amount from the issue. In this process, investment banker buys the security at a lower price and then sells them at a higher price

**2. Distributing**

Once the investment banker owns new securities. it must get them into the hands of ultimate investors. Hence, the second function of investment banker is marketing new issue of securities. The investment banker is a specialist with a staff and organization to distribute securities. So, they perform physical distribution functions more efficiently and more economically than and individual company.

**3. Advising**

The investment banker, through experience becomes an expert in the issuance and marketing of new securities. Business firms may take valuable advice and counsel from the investment bankers. Thus, investment bankers perform an advisory function by analyzing the firm's financial needs and recommending appropriate means of financing.

**4. Making a Market**

In case of a company going public for the first time, the investment banker may be obliged to maintain a market for the shares after the issue. The investment banker generally agrees to make a market in the stock and to keep it reasonably liquid.

1. **Describe the concept of central bank. Discuss the functions of RBI.**  (3)

Ans- A central bank is an independent national authority that conducts monetary policy, regulates banks, and provides financial services including economic research. Its goals are to stabilize the nation's currency, keep unemployment low, and prevent **inflation**

**Traditional functions of RBI**

Traditional functions are those functions which every central bank of each nation performs all over the world. Basically these functions are in line with the objectives with which the bank is set up. It includes fundamental functions of the Central Bank. They comprise the following tasks.

1. **Issue of Currency Notes**

The RBI has the sole right or authority or monopoly of issuing currency notes except one rupee note and coins of smaller denomination. These currency notes are legal tender issued by the RBI. Currently it is in denominations of Rs. 5, 10, 20, 50, 100, 500, and 1,000. The RBI has powers not only to issue and withdraw but even to exchange these currency notes for other denominations. It issues these notes against the security of gold bullion, foreign securities, rupee coins, exchange bills and promissory notes and government of India bonds.

1. **Banker to other Banks**

The RBI being an apex monitory institution has obligatory powers to guide, help and direct other commercial banks in the country. The RBI can control the volumes of banks reserves and allow other banks to create credit in that proportion. Every commercial bank has to maintain a part of their reserves with its parent's viz. the RBI. Similarly in need or in urgency these banks approach the RBI for fund. Thus it is called as the lender of the last resort.

1. **Banker to the Government**

The RBI being the apex monitory body has to work as an agent of the central and state governments. It performs various banking function such as to accept deposits, taxes and make payments on behalf of the government. It works as a representative of the government even at the international level. It maintains government accounts, provides financial advice to the government. It manages government public debts and maintains foreign exchange reserves on behalf of the government. It provides overdraft facility to the government when it faces financial crunch.

1. **Exchange Rate Management**

It is an essential function of the RBI. In order to maintain stability in the external value of rupee, it has to prepare domestic policies in that direction. Also it needs to prepare and implement the foreign exchange rate policy which will help in attaining the exchange rate stability. In order to maintain the exchange rate stability it has to bring demand and supply of the foreign currency (U.S Dollar) close to each other.

1. **Credit Control Function**

Commercial bank in the country creates credit according to the demand in the economy. But if this credit creation is unchecked or unregulated then it leads the economy into inflationary cycles. On the other credit creation is below the required limit then it harms the growth of the economy. As a central bank of the nation the RBI has to look for growth with price stability. Thus it regulates the credit creation capacity of commercial banks by using various credit control tools.

1. **Supervisory Function:**

The RBI has been endowed with vast powers for supervising the banking system in the country. It has powers to issue license for setting up new banks, to open new branches, to decide minimum reserves, to inspect functioning of commercial banks in India and abroad, and to guide and direct the commercial banks in India. It can have periodical inspections an audit of the commercial banks in India.

RBI has authority to regulate and administer the entire banking and financial system. Some of its supervisory functions are given below.

* **Granting license to banks -** The RBI grants license to banks for carrying its business. License is also given for opening extension counters, new branches, even to close down existing branches.
* **Bank Inspection -** The RBI grants license to banks working as per the directives and in a prudent manner without undue risk. In addition to this it can ask for periodical information from banks on various components of assets and liabilities.
* **Control over NBFIs** - The Non-Bank Financial Institutions are not influenced by the working of a monitory policy. However RBI has a right to issue directives to the NBFIs from time to time regarding their functioning. Through periodic inspection, it can control the NBFIs.
* **Implementation of the Deposit Insurance Scheme -** The RBI has set up the Deposit Insurance Guarantee Corporation in order to protect the deposits of small depositors. All bank deposits below Rs. One lakh are insured with this corporation. The RBI work to implement the Deposit Insurance Scheme in case of a bank failure.

**Promotional functions of RBI**

Along with the routine traditional functions, central banks especially in the developing country like India have to perform numerous functions. These functions are country specific functions and can change according to the requirements of that country. Some of the major development functions of the RBI are given below.

1. **Development of the Financial System**

The financial system comprises the financial institutions, financial markets and financial instruments. The sound and efficient financial system is a precondition of the rapid economic development of the nation. The RBI has encouraged establishment of main banking and non-banking institutions to cater to the credit requirements of diverse sectors of the economy.

1. **Development of Agriculture**

In an agrarian economy like ours, the RBI has to provide special attention for the credit need of agriculture and allied activities. It has successfully rendered service in this direction by increasing the flow of credit to this sector. It has earlier the Agriculture Refinance and Development Corporation (ARDC) to look after the credit, National Bank for Agriculture and Rural Development (NABARD) and Regional Rural Banks (RRBs).

1. **Provision of Industrial Finance**

Rapid industrial growth is the key to faster economic development. In this regard, the adequate and timely availability of credit to small, medium and large industry is very significant. In this regard the RBI has always been instrumental in setting up special financial institutions such as ICICI Ltd. IDBI, SIDBI and EXIM BANK etc.

1. **Provisions of Training**

The RBI has always tried to provide essential training to the staff of the banking industry. The RBI has set up the bankers' training colleges at several places. National Institute of Bank Management i.e NIBM, Bankers Staff College i.e BSC and College of Agriculture Banking i.e CAB are few to mention.

1. **Collection of Data**

Being the apex monetary authority of the country, the RBI collects process and disseminates statistical data on several topics. It includes interest rate, inflation, savings and investments etc. This data proves to be quite useful for researchers and policy makers.

1. **Publication of the Reports**

The Reserve Bank has its separate publication division. This division collects and publishes data on several sectors of the economy. The reports and bulletins are regularly published by the RBI. It includes RBI weekly reports, RBI Annual Report, Report on Trend and Progress of Commercial Banks India., etc. This information is made available to the public also at cheaper rates.

1. **Promotion of Banking Habits**

As an apex organization, the RBI always tries to promote the banking habits in the country. It institutionalizes savings and takes measures for an expansion of the banking network. It has set up many institutions such as the Deposit Insurance Corporation-1962, UTI-1964, IDBI-1964, NABARD- 1982, NHB-1988, etc. These organizations develop and promote banking habits among the people. During economic reforms it has taken many initiatives for encouraging and promoting banking in India.

1. **Promotion of Export through Refinance**

The RBI always tries to encourage the facilities for providing finance for foreign trade especially exports from India. The Export-Import Bank of India (EXIM Bank India) and the Export Credit Guarantee Corporation of India (ECGC) are supported by refinancing their lending for export purpose.

1. Define the investment banker’s roles and functions. (3)

Ans- ***Functions Of Investment Bankers***

The traditional function of the investment bankers has been to act as middlemen in channeling individual's savings and funds into the purchase of business securities. But now a days, they also provide advice and help in distribution of securities. Thus, investment bankers perform four basic functions as follows:

**1. Underwriting**

When underwriting a security issue, an investment banker guarantees the issuer that it will receive a specific amount from the issue. In this process, investment banker buys the security at a lower price and then sells them at a higher price i.e. offer price to public. In this sense, underwriting is the insurance function of bearing the risks of adverse price fluctuation during the period of distribution. Investment bankers take this risk for a specific amount of underwriting spread or commission. If investment banker can not sell securities at specified price, the underwriter, not the company, suffers the loss. Underwriter's gain or loss is computed using the following equation.

*Gain or loss to underwriter = Gross proceed- proceed to the company- underwriter's expenses.*

*Where,*

*Gross proceed = price to public X number of shares to be issued.*

**2. Distributing**

Once the investment banker owns new securities. it must get them into the hands of ultimate investors. Hence, the second function of investment banker is marketing new issue of securities. The investment banker is a specialist with a staff and organization to distribute securities. So, they perform physical distribution functions more efficiently and more economically than and individual company.

**3. Advising**

The investment banker, through experience becomes an expert in the issuance and marketing of new securities. Business firms may take valuable advice and counsel from the investment bankers. Thus, investment bankers perform an advisory function by analyzing the firm's financial needs and recommending appropriate means of financing.

**4. Making A Market**

In case of a company going public for the first time, the investment banker may be obliged to maintain a market for the shares after the issue. The investment banker generally agrees to make a market in the stock and to keep it reasonably liquid. In making a market, the underwriter maintains an inventory in the stocks, quotes bid and asked prices, and stands ready to buy and sell it at those prices. Thus, investment banker also helps to maintain an active secondary market in the stock of small and newly established company.

1. **Explain the concept of money market. Define the functions of money market.** (3)

Ans- The money market is a market for short-term instruments that are close substitutes for money. The short term instruments are highly liquid, easily marketable, with little change of loss. It provides for the quick and dependable transfer of short term debt instruments maturing in one year or less, which are used to finance the needs of consumers, business agriculture and the government. The money market is not one market but is “a collective name given to the various form and institutions that deal with the various grades of near ­money.”

### Functions of a Money Market:

A money market performs a number of functions in an economy.

#### 1. Provides Funds:

It provides short-term funds to the public and private institutions needing such financing for their working capital requirements. It is done by discounting trade bills through commercial banks, discount houses, brokers and acceptance houses. Thus the money market helps the development of commerce, industry and trade within and outside the country.

#### 2. Use of Surplus Funds:

It provides an opportunity to banks and other institutions to use their surplus funds profitably for a short period. These institutions include not only commercial banks and other financial institutions but also large non-financial business corporations, states and local governments.

#### 3. No Need to Borrow from Banks:

The existence of a developed money market removes the necessity of borrowing by the commercial banks from the central bank. If the former find their reserves short of cash requirements they can call in some of their loans from the money market. The commercial banks prefer to recall their loans rather than borrow from the central banks at a higher rate of interests.

#### 4. Helps Government:

The money market helps the government in borrowing short-term funds at low interest rates on the basis of treasury bills. On the other hand, if the government were to issue paper money or borrow from the central bank. It would lead to inflationary pressures in the economy.

#### 5. Helps in Monetary Policy:

A well-developed money market helps in the successful implementation of the monetary policies of the central bank. It is through the money market that the central banks are in a position to control the banking .system and thereby influence commerce and industry.

#### 6. Helps in Financial Mobility:

By facilitating the transfer for funds from one sector to another, the money market helps in financial mobility. Mobility in the flow of funds is essential for the development of commerce and industry in an economy.

#### 7. Promotes Liquidity and Safety:

One of the important functions of the money market is that it promotes liquidity and safety of financial assets. It thus encourages savings and investments.

#### 8. Equilibrium between Demand and Supply of Funds:

The money market brings equilibrium between the demand and supply of loanable funds. This it does by allocating saving into investment channels. In this way, it also helps in rational allocation of resources.

#### 9. Economy in Use of Cash:

As the money market deals in near-money assets and not money proper, it helps in economising the use of cash. It thus provides a convenient and safe way of transferring funds from one place to another, thereby immensely helping commerce and industry.

1. **Explain the objectives and evolution of financial services.** (3)

Ans- **Concept of Financial services**

The term financial services in a broad sense means “mobilizing and allocating saving”. Financial services are a term used to refer to the [services](http://en.wikipedia.org/wiki/Service) provided by the [finance](http://en.wikipedia.org/wiki/Finance) industry. Financial services are also the term used to describe organizations that deal with the management of money.

[Banks](http://en.wikipedia.org/wiki/Merchant_bank), Investment banks, [credit card](http://en.wikipedia.org/wiki/Credit_card) companies, consumer finance companies, [government sponsored enterprises](http://en.wikipedia.org/wiki/Government_sponsored_enterprises), specialized services like factoring, Securitization, venture capital and [stock brokerages](http://en.wikipedia.org/wiki/Stock_broker) are examples of the types of firms comprising the Industry, which provides a variety of money and investment and related services.

Objectives of financial sector reforms

* + To improving efficiency and effectiveness of the financial system
  + Operational freedom for flexibility to the financial system through prudential regulation and supervision in a free financial environment

**Section B**

1. **Write short note on following:**

**(i) Repo transaction (ii) Treasury Bills (iii) Call money (iv) CD (4)**

Ans- (i) **Repo Transaction:**

A repurchase agreement (repo) is a form of [short-term](http://www.investopedia.com/terms/s/shortterm.asp) borrowing for [dealers](http://www.investopedia.com/terms/d/dealer.asp) in [government securities](http://www.investopedia.com/terms/g/governmentsecurity.asp). The dealer [sells](http://www.investopedia.com/terms/s/sell.asp) the government securities to [investors](http://www.investopedia.com/terms/i/investor.asp), usually on an overnight basis, and [buys](http://www.investopedia.com/terms/b/buy.asp) them back the following day.

For the party selling the security and agreeing to repurchase it in the future, it is a repo; for the party on the other end of the transaction, buying the security and agreeing to sell in the future, it is a [reverse repurchase agreement](http://www.investopedia.com/terms/r/reverserepurchaseagreement.asp).

#### (ii) Treasury Bill:

But the major instrument of the money markets is the Treasury bill which is issued for varying periods of less than one year. They are issued by the Secretary to the Treasury in England and are payable at the Bank of England. There are also the short-term government securities in the USA which are traded by commercial banks and dealers in securities. In India, the treasury bills are issued by the Government of India at a discount generally between 91 days and 364 days. There are three types of treasury bills in India—91 days, 182 days and 364 days.

(iii) **Call Money**:

There is the call money market in which funds are borrowed and lent for one day. In the notice market, they are borrowed and lent upto 14 days without any collateral security. But deposit receipt is issued to the lender by the borrower who repays the borrowed amount with interest on call. In India, commercial banks and cooperative banks borrow and lend funds in this market but mutual funds and all-India financial institutions participate only as lenders of funds.

#### (iv) Certificates of Deposits (CD):

Certificates of deposits are issued by commercial banks at a discount on face value. The discount rate is determined by the market. In India the minimum size of the issue is Rs. 25 lakhs with the minimum subscription of Rs. 5 lakhs. The maturity period is between 3 months and 12 months.

1. **Describe the role of central bank in development of country’s economy. Briefly explain the issues of RBI.**  **(4)**

Ans- **CONTRIBUTION OF RBI TO INDIA :**

* The economic importance of commercial banks to developing countries may be viewed thus :
* Promoting capital formation
* Encouraging innovation
* Monetisation
* Influence economic activity
* Facilitator of monetary policy
* **PROMOTING CAPITAL FORMATION**

A developing economy needs a high rate of capital formation to accelerate the tempo of economic development, but the rate of capital formation depends upon the rate of saving.RBI makes sure the banks afford facilities for saving and, thus encourage the habits of thrift and industry in the community. They mobilize the ideal and dormant capital of the country and make it available for productive purposes. RBI regulates the policies of money lending, interest etc to make sure promotion of capital formation takes place.

* **ENCOURAGING INNOVATION**

The entrepreneur in innovation is largely dependent on the manner in which bank credit is allocated and utilized in the process of economic growth. Bank credit enables entrepreneurs to innovate and invest, and thus uplift economic activity and progress. RBI has the power to decide policy in relation to advances to be followed by Banking Companies which makes sure there is availability of attractive policies for investors etc.

* **MONETSATION**

Banks are the manufactures of money and they allow many to play its role freely in the economy. Banks monetize debts and also assist the backward subsistence sector of the rural economy by extending their branches in to the rural areas. RBI keeps a check on opening of branches to providing them with licenses. Moreover, for remitting any debt due to the bank by its directors, prior approval of RBI is required.

* **INFLUENCE ECONOMIC ACTIVITY**

Banks are in a position to influence economic activity in a country by their influence on the rate interest etc. They can influence the rate of interest in the money market through its supply of funds. Banks may follow a cheap money policy with low interest rates which will tend to stimulate economic activity. In order to regulate any disaster in the financial status of the country RBI plays a very important role.

* **FACILITATOR OF MONETARY POLICY**

Thus monetary policy of a country should be conductive to economic development. But a well-developed banking system is on essential pre-condition to the effective implementation of monetary policy. Under-developed countries cannot afford to ignore this fact. A fine, an efficient and comprehensive banking system is a crucial factor of the developmental process of economy. RBI plays a very important role in regulating all the banks, policies, branches etc which makes sure stability and transparency in the banking system of India. This ultimately leads to a very well established and governed banking system in India.

**Issues and challenges of RBI:**

Here are the five key challenges Patel will likely faces in the coming months:

**1) BAD LOANS**

The banking sector has been beset with bad loans that have risen due to slow growth, delays in project implementation and high willful default rates.

**2) MONETARY POLICY COMMITTEE**

Patel will be the first to oversee interest rate decisions by a monetary policy committee (MPC), a six-member panel chaired by the RBI governor to decide on interest rates.

The governor will not enjoy a veto power, but will cast his vote in case of a tie.

The decision of the committee -- three each nominated by the government and the central bank – will be binding on the central bank.

**3) RUPEE and FCNR**

The rupee, currently hovering around 67 to a dollar, could take knock in the next three months. A spurt in dollars outflows are expected during September and November as depositors withdraw money parked in foreign currency non-resident (FCNR) deposits.

**4) NEW DIGITAL BANKS**

A string of digital payments and small finance banks will start operations in the coming months.

A payment bank is a differentiated bank that is allowed to carry out restricted banking functions. Payments banks can collect deposits, but cannot lend. These institutions are primarily aimed at giving access to formal banking services to those at the lower end of the income scale and also in remote areas.

**5) MANAGING POLITICAL RELATIONS**

The new governor will have to live up the reputation of fiercely protecting RBI’s autonomy and show the ability to withstand mounting political pressure that could arise during the course of the central bank chief’s tenure.

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[Min. Passing Marks: 08]

Instructions to the Candidates:

Attempt any 4 questions from Section A and Section B is Compulsory.

**Section A**

1. **Explain in detail the importance of financial system for the development of the country. (3)**

## Ans- Role of Financial System in Economic Development

The financial system of a country is of immense use and plays a vital role in shaping the economic development for a nation. The volume and growth of the capital in the economy solely depends on the efficiency and intensity of the operations and activities carried out in the financial markets. An immature financial system hinders the growth of the economy and leads to the ruined economy, as the policies of the market are not clear to both the national and foreign investors thus ruining the development of the economy big time.

The major role of financial system can be explained by the following few key points:

* Financial intermediaries enhance the **investment** in the economy, by the means of the direct and indirect investments
* The process of transferring the **monetary resources** of the public into the financial resources by the financial intermediaries involves maturity intermediation, risk reduction through diversification, reducing costs of transaction and provides a payment mechanism, which in turn is the sole objective of the financial market.

Thus the financial market of a country forms one of the pillars of the economy, on which the success of the nation is dependent largely. The economic reforms and the growth of the individuals and the nation as a whole are highly interrelated to the working of the financial market.

### Changes in the Indian Economy

i) Significant **diversification and policy reformation** has led to the restructuring of the financial institutions, which in turn have accompanied the growth of Indian Financial System largely.

ii) In the past 50 years the Indian financial system has shown tremendous **growth** in terms of quantity, sophistication, innovations and complexity of operation, diversity, involvement.

iii) Major **financial indicators** which include money supply, deposits and credit of banks, primary and secondary issues have increased rapidly.

iv) India has also witnessed all the major types of **financial innovations** like diversification, disintermediation, securitization, liberalization, globalization, privatization, etc.

v) The **financial institutions** and a large number of new financial instruments lead a fairly diversified portfolio of financial claims which altogether have helped India to position itself in Global market.

1. **Define the concept of banking services. Briefly explain the types of banks. (3)**

Ans- A bank is a company that provides financial services of various sorts to various types of customers.  Its major function is to gather money from various people and to lend that money out to other people.

One of the most visible things that a bank does is to take deposits from customers and act as a place for them to store their money.

Checking accounts. Savings accounts. Debit and credit cards. Merchant **services** (credit card processing, reconciliation and reporting, check collection) Cash management (payroll **services**, deposit **services**, etc.)

**Types of Bank:**

**Commercial Bank:** A commercial bank is a financial institution that provides various financial service, such as accepting deposits and issuing loans. Commercial bank customers can take advantage of a range of [investment products](http://www.investopedia.com/terms/i/investment-product.asp) that commercial banks offer like [savings accounts](http://www.investopedia.com/terms/s/savingsaccount.asp) and [certificates of deposit](http://www.investopedia.com/terms/c/certificateofdeposit.asp). The loans a commercial bank issues can vary from business loans and auto loans to mortgages.

**Development Banks:** Development Banks are the institutions engaged in the promotion and development of industry ,agriculture and other key sectors. A development bank is an institution which takes up the job of developing industrial enterprises from its inception to completion.

**Investment bank:** An investment bank is typically a private company that provides various financial-related and other services to individuals, corporations, and governments such as raising financial capital by underwriting or acting as the client's agent in the issuance of securities.

**International Banking:** An international bank is a financial entity that offers financial services, such as payment accounts and lending opportunities, to foreign clients. These foreign clients can be individuals and companies, though every international bank has its own policies outlining with whom they do business.

1. **Write short note on following:**

**(i) Commercial paper (ii) Participation certificate (3)**

#### Ans- (i) Commercial Paper (CP): Commercial papers are issued by highly rate companies to raise short-term working capital requirements directly from the market instead of borrowing from the banks. CP is a promise by the borrowing company to repay the load at a specified date, normally for a period of 3 months to 6 months.

**(ii) Participation Certificate (PC):** A Participation Certificate (PC) (also known as a Certificate of Participation) is a financial instrument, a form of financing, used by municipal or government entities which allows an individual to buy a share of the lease revenue of an agreement made by these entities.

Participation certificates are a new form of credit instrument whereby [banks](https://en.wikipedia.org/wiki/Bank) can raise funds from other banks and other central bank approved financial institutions to ease [liquidity](https://en.wikipedia.org/wiki/Liquidity). In this case banks have the option to share their [credit](https://en.wikipedia.org/wiki/Credit_(finance)) [asset](https://en.wikipedia.org/wiki/Asset)(s) with other banks by issuing participation certificates. With this participation approach, banks and financial institutions come together either on risk sharing or non-risk sharing basis. While providing short term funds, participation certificates can also be used to reduce risk. The rate at which these certificates can be issued will be negotiable depending on the [interest rate](https://en.wikipedia.org/wiki/Interest_rate) scenario.

1. **Define the features of money market. Explain the players of money market. (3)**

Ans- The money market is a market for short-term instruments that are close substitutes for money. The short term instruments are highly liquid, easily marketable, with little change of loss. It provides for the quick and dependable transfer of short term debt instruments maturing in one year or less, which are used to finance the needs of consumers, business agriculture and the government. The money market is not one market but is “a collective name given to the various form and institutions that deal with the various grades of near ­money.”

### Institutions of the Money Market:

The various financial institutions which deal in short term loans in the money market are its members. They comprise the following types of institutions:

#### 1. Central Bank:

The central bank of the country is the pivot around which the entire money market revolves. It acts as the guardian of the money market and increases or decreases the supply of money and credit in the interest of stability of the economy. It does not itself enter into direct transactions. But controls the money market through variations in the bank rate and open market operations.

#### 2. Commercial Banks:

Commercial banks also deal in short-term loans which they lend to business and trade. They discount bills of exchange and treasury bills, and lend against promissory notes and through advances and overdrafts.

#### 3. Non-bank Financial Intermediaries:

Besides the commercial banks, there are non-bank financial intermediaries which lend short-term funds to borrowers in the money market. Such financial intermediaries are savings banks, investment houses, insurance companies, provident funds, and other financial corporations.

#### 4. Discount Houses and Bill Brokers:

In developed money markets, private companies operate discount houses. The primary function of discount houses is to discount bills on behalf of other. They, in turn, form the commercial banks and acceptance houses. Along-with discount houses, there are bill brokers in the money market who act as intermediaries between borrowers and lenders by discounting bills of exchange at a nominal commission. In underdeveloped money markets, only bill brokers operate.

#### 5. Acceptance Houses:

The institution of acceptance houses developed from the me change bankers who transferred their headquarters to the London Money Market in the 19th and the early 20 the century. They act as agents between exporters and importers and between lender and borrower traders. They accept bills drawn on merchants whose financial standing is not known in order to make the bills negotiable in the London Money Market. By accepting a trade bill they guarantee the payment of bill at maturity. However, their importance has declined because the commercial banks have undertaken the acceptance business.

1. **Discuss the issues and challenges of international banking. (3)**

Ans- **The Challenges**

**New accounts usually need to be opened in person.**  This does not mean that they should wait until they arrive to begin researching their options.  Employees may have to jump through many administrative hurdles before opening local bank accounts and often will need specific identification.

A passport will typically work, but some banks require two forms of I.D. – only one of which can be foreign. Your assignees should research what is specifically required to open an account and prepare accordingly to avoid a prolonged and frustrating experience.

Other documents that could be required, depending on the bank and account type, include:

* A receipt from the immigration bureau stating that a permit is in process
* A bank reference or recent financial statement from one’s home bank
* A credit history report
* An employment contract or letter from the employer, including salary information and the length of the contract
* Proof of address, such as a utility bill or rental contract
* A certificate of registration with the local police

**Inconsistent practices and frequent changes to the rules.** Each country and each bank has its own unique procedures and document requirements for banking.  Often within the same bank, your assignees could be faced with differing interpretations of rules depending on with whom they speak.  It will help for them to keep the name of the person who assisted them and try to work with that person consistently.

Your assignees cannot rely on a co-worker’s experience to determine what you will need, nor can they expect that what was researched earlier will still be applicable when they arrive in country.

**Services may only be offered in the local language.**  Due to the complexity of banking abroad, NEI recommends that you work with a bank that speaks your language.

**Local banks may not be as familiar with services that your assignees may need.**  Sometimes local banks give preferential treatment to local customers, yet those banks may not have the necessary experience that a large, global bank has to successfully manage your account.  Your assignees will be faced with many unique situations that local customers will not experience, such as currency conversions, split payrolls, etc.

**FACTA compliance.**FACTA refers to the U.S. IRS Foreign Account Tax Compliance Act.  If your assignees are working with a bank that is not FACTA compliant, their money is subject to a 30% withholding tax on all U.S. sourced income to foreign entities. Though 77,000 institutions have agreed to pass data to the IRS, many other foreign banks are refusing to offer banking services to U.S. connected customers rather than risk FACTA consequences of accidental non-compliance. In a 2014 survey, 13% of 6,552 Americans reported being unable to open an account because of FACTA.

**Country requirements.** Some countries have very strict regulations on what must happen before an account can be closed.  Use Brazil as an example: the country requires local payment of some portion of the salary.  Typically, the company will have an associated bank that can make getting the account set-up and having the payroll deposits go much smoother.

However, at the end of the assignment, the account cannot be shut down until all local payments have been completed and any final taxes have been settled.  Without having the final taxes settled, any credits typically due require another, arduous method to claim.

1. **Describe the role of RBI in bank management and regulation. (3)**

Ans- **Role of RBI in bank management & regulation**

RBI derives its regulating powers for Indian Banking System from the provisions of the **Banking Regulation Act 1949.** For other entities, it derives power from the **RBI act 1934**. The objectives of this function are to protect the interest of the depositors and maintain the safety and soundness of the banking and Financial System of the country.

Further, various departments have been created for effective supervisory functions. For example:

* Department of Banking Operations and Development (DBOD) frames regulations for commercial banks.
* Department of Banking Supervision (DBS) undertakes supervision of commercial banks, including the local area banks and all-India financial institutions.
* Department of Non-Banking Supervision (DNBS) regulates and supervises the Non-Banking Financial Companies (NBFCs)
* Urban Banks Department (UBD) regulates and supervises the Urban Cooperative Banks (UCBs).

Regulation of Regional Rural Banks (RRBs) and the Rural Cooperative Banks is done by Rural Planning and Credit Department (RPCD); while the supervision of these comes under NABARD

**Section B**

1. **What do you understand by development bank? Explain its issues and trends. (4)**

Ans- Development Banks are the institutions engaged in the promotion and development of industry ,agriculture and other key sectors. A development bank is an institution which takes up the job of developing industrial enterprises from its inception to completion.

**Features of a Development Bank:**

Following are the main characteristic features of a development bank:

1. It is a specialised financial institution.

2. It provides medium and long term finance to business units.

3. Unlike commercial banks, it does not accept deposits from the public.

4. It is not just a term-lending institution. It is a multi-purpose financial institution.

**Issues of Development bank:**

#### 1. Lack of Co-ordination in Branch Expansion:

Haste in branch expansion programme in many cases has resulted in lopsidedness due to lack of co-ordination. In several cases, it could not be ensured that the branches of the RRBs are opened at centres where no commercial or co-operative banking facilities were provided.

#### 2. Difficulties in Deposit Mobilisation:

The RRBs encountered a number of practical difficulties in deposit mobilisation. On account of their restrictive lending policy which excludes richer sections of the village society, these potential depositors show least interest in depositing their money with these banks.

#### 3. Constraints in Deposit Mobilisation:

The RRBs exclude the richer sections of the village society in providing direct financial assistance. These sections have potential savings to deposit. But, they are least interested in depositing them with the RRBs in view of the restrictive credit policy of these banks. Further, state and local governments and their agencies also have not co-operated much by maintaining their deposit accounts with the RRBs.

#### 4. Slow Progress in Lending Activity:

The RRBs’ pace of growth in loan business is slow. For this the following reasons may be given: (i) There have been limited scope for direct lending by RRBs in their fields of operations; (ii) It is always difficult to identify the potential small borrowers and the bank staff have been required to make special and sincere efforts in this regard; (iii) Most of the small borrowers do not like the bank formalities and prefer to borrow from the informal/indigenous sources of finance, such as money­lenders; (iv) The anomalies in the Differential Interest Rate (DIR) Scheme also posed a special problem to the RRBs.

#### 5. Urban-Orientation of Staff:

A crucial practical difficulty experienced in their working by the RRBs is the urban orientation of their staff which is rarely inclined to serve in rural areas. There is no true local involvement of the bank staff in the village where they serve.

**Trends in Development Banking**

* SIDBI
* ICICI
* IFCI
* GIC
* LIC
* IDFC
* NABARD
* EXIM

1. **Define the money market and its structure. (4)**

Ans- The money market is a market for short-term instruments that are close substitutes for money. The short term instruments are highly liquid, easily marketable, with little change of loss. It provides for the quick and dependable transfer of short term debt instruments maturing in one year or less, which are used to finance the needs of consumers, business agriculture and the government. The money market is not one market but is “a collective name given to the various form and institutions that deal with the various grades of near ­money.”

### Institutions of the Money Market:

The various financial institutions which deal in short term loans in the money market are its members. They comprise the following types of institutions:

#### 1. Central Bank:

The central bank of the country is the pivot around which the entire money market revolves. It acts as the guardian of the money market and increases or decreases the supply of money and credit in the interest of stability of the economy. It does not itself enter into direct transactions. But controls the money market through variations in the bank rate and open market operations.

#### 2. Commercial Banks:

Commercial banks also deal in short-term loans which they lend to business and trade. They discount bills of exchange and treasury bills, and lend against promissory notes and through advances and overdrafts.

#### 3. Non-bank Financial Intermediaries:

Besides the commercial banks, there are non-bank financial intermediaries which lend short-term funds to borrowers in the money market. Such financial intermediaries are savings banks, investment houses, insurance companies, provident funds, and other financial corporations.

#### 4. Discount Houses and Bill Brokers:

In developed money markets, private companies operate discount houses. The primary function of discount houses is to discount bills on behalf of other. They, in turn, form the commercial banks and acceptance houses. Along-with discount houses, there are bill brokers in the money market who act as intermediaries between borrowers and lenders by discounting bills of exchange at a nominal commission. In underdeveloped money markets, only bill brokers operate.

#### 5. Acceptance Houses:

The institution of acceptance houses developed from the me change bankers who transferred their headquarters to the London Money Market in the 19th and the early 20 the century. They act as agents between exporters and importers and between lender and borrower traders. They accept bills drawn on merchants whose financial standing is not known in order to make the bills negotiable in the London Money Market. By accepting a trade bill they guarantee the payment of bill at maturity. However, their importance has declined because the commercial banks have undertaken the acceptance business.

**Money Market Structure:**

1. Unorganized Market

* Money Lenders
* Indigenous Bankers
* Chit Funds

2. Organized Money Market

* Treasury Bills
* Commercial Paper (CP)
* Certificate Of Deposit (CD) etc.
* Call Money Market
* Commercial Bill Market