Basics of Banking

A Pinku and Dadaji

Series

Banks are life blood of any nation

Pinku and Dadaji were good friends.

Today is Pinku's Birthday.

Dadaji: Pinku...my boy...wishing you many happy returns of the day

Pinku: Thank you Dadaji... On my birthday occasion what did you bring for me Dadaji?

Dadaji: Here it is... It's a Kiddie Bank.

Pinku: Kiddie Bank hmm... what is a kiddie bank Dadaji?

Dadaji: "Well" you get your pocket money right... Do you spend all the money that you get in a day?

Pinku: No Dadaji... I give back the remaining money to my mom after I spend some.

Dadaji: Why not save this remaining money in this "Kiddie Bank". When your Kiddie Bank is full you can spend as you want.

Pinku: That's a fantastic idea Dadaji... "I Love You"... Dadaji my father also saves his money in a Bank. Can you tell me what a Bank is?

Dadaji: My Son...A bank is a place where we either save money or borrow money. We save our money in deposits with the bank and borrow money from bank through Loans.

Pinku: Yes Dadaji I understood... Yesterday I forgot to carry pen to school and borrowed Mantu's pencil. So I loaned a pencil from Mantu... right Dadaji...

Small Savings brings in Huge Wealth one day

Dadaji: Correct Pinku...

Pinku: But he did not give his pen for free. He took my laddu's in the lunch time.

Dadaji: Ah!!! Intelligent boy... Mantu. Similar to Mantu, Banks also don't loan free of cost. As you had to give your laddu's for borrowing pen, similarly Banks charge interest for the loaned money.

Pinku: Interest... hmm... what is interest Dadaji?

Dadaji: Interest is the cost for the amount used by you. Generally banks charges interest on yearly basis also called per annum. Do you know there are two types of loans?

Pinku: And Dadaji what are they?

Dadaji: These are a) Secured Loans and b) Unsecured Loans.

Save your money in banks, it's safe there

You remember Pinku; your father last week purchased a house and last month a new car. He purchased the house and car through bank loan. Let's imagine if your father is unable to pay the loan, the bank has all the rights to seize the house and car. So, in simple, secured loans are usually the best way to obtain large amounts of money and these loans are protected by an asset (such as house/vehicle) or some sort of collateral/security. The bank will hold the deed or title of the house/car until the loan has been paid in full, including interest and all applicable fees.

Pinku: Ah..! I understood

Dadaji: On the other hand bank also provides unsecured Loan. These loans come with no property or assets to recover in case of default/ nonpayment, which is why the interest rates are considerably higher. So, when you apply for a loan that is unsecured, the Bank believes that you can repay the loan on the basis of your financial resources. You remember last summer our family went to Ooty. In order to spend during the trip your father took personal loan. Also, all those things like your sweater, toys and your clothes were purchased through credit card. So a credit card or a personal loan is example of unsecured loans.

Bank comes from the word Bancu/Banco

Pinku: Fantastic! Dadaji… So, a house loan or a car loan is a secured loan where bank can recover money in case of nonpayment of loan and Credit card or a personal loan is unsecured as it is given by the bank believing our financial status… hmm…

Pinku: Well Dadaji a basic question came in my mind. Why a Bank is called a Bank?

Dadaji: Its simple Pinku…Bank comes from an Italian word "Banco/Bancu" whose meaning is bench. Italian merchants in olden days (during Renaissance period) dealt with money between each other beside a bench. They used to place the money on that bench. Slowly the name Banco changed to Bank through the time.

Pinku: Hmm… Bench-Banco-Bank… Good to know that Dadaji…

Banks are financial conveniences

Pinku: Dadaji another basic question... how is a bank formed?

Dadaji: A banking license is a prerequisite for a financial institution that wants to provide banking services. RBI provides Banking license to become a bank in India. There is a relatively long and complicated procedure that goes into the application for obtaining license. This procedure will also depend on the type of bank license that you wish to apply for. Licensing is generally broken down into different categories, while each category has a different specialization, and a different time frame involved in the banking license application process. Due to the number of different sectors in which banks may be involved, there are also bank licensing packages available. The main bank license is the one that allows the bank to engage in all of the activities that one would expect a major bank to partake in, including retail banking, merchant acquiring, cash management, asset management and trading. Obtaining a bank license that allows you to engage in all of these activities will generally take the longest, and cost the most. Additionally, however, you can apply for one that has fewer or even only one specialization. But it's not easy to get the license there are still several applications lined up with RBI for issuance of bank license.

Bank License is the prerequisite of any bank

Pinku: Hmmm that's how it goes. Apply for license with RBI and upon approval you become a bank. Dadaji... While you were explaining Bank, you told something Deposit... What is a deposit?

Dadaji: Pinku... A deposit is our own money kept with bank. An account number is provided for each kind of deposits that we hold with the bank. This account allows money to be deposited and withdrawn by the account holder. Deposit accounts are of various kinds. Banks mainly have four types of deposit accounts namely Current Account, Saving Account (combined called as CASA account), Recurring Deposit, and Fixed Deposit.

Pinku: What is a Current Account Dadaji?

Current Account pay's no interest

Dadaji: My Son…Current Account is meant for business people who want money instantaneously as and when required for the business. Hence, this account is never used for the purpose of savings. As the money is required by the businessmen instantly there are no limits for number of transactions or the amount of transactions in a day for the account holders. Cheque book facility is provided to the account holder. No interest is paid by banks on these accounts.

Pinku: Oh… so only business people open this account correct Dadaji…?

Dadaji: Not always, anyone can open a current account. However, current account is meant for only those who have daily transactions in bank. Hence, mainly business people open current accounts.

Pinku: What is a saving account Dadaji?

Dadaji: Saving accounts are meant for individuals like us who wants to save hard earned money. This account is flexible and comes with varieties of conveniences such as cheque book and Debit Card. Banks usually encourage this type of account and also pay interest on money that has been deposited in these accounts.

CASA (Current Account/ Savings Account)

That's not all Pinku… Both Current Account and Savings Account together are also called CASA accounts. CASA accounts are called "demand deposits" as you can withdraw the amount from these accounts as and when required by you or demanded by you with the bank. They are Demand liabilities for the bank. Meaning, the bank is liable to pay you as and when you require the amount from these accounts.

Pinku: I don't understand one thing Dadaji… Why an interest is paid for savings account and why not for current account?

Dadaji: My son… Bank is for our conveniences and they have designed these accounts based on each individual's convenience. Bank wants to pay interest as savings are believed to be kept in account for a longer period. However, the money in current account is used for short period.

Banks pay you to save your own money

Hence, obviously it does not make sense for the bank to pay interest.

Pinku: Yes Dadaji that does make sense. Then, what is a fixed deposit?

Dadaji: Fixed deposit popularly known as FD accounts are one time deposit taken by the bank from depositors for a length of time. Depositors have the choice of the length of time which is in the range of 7 days to 10 years. The interest amount and the tenure of the deposit are fixed at the time of depositing money. However, if required, the FD can be broken before maturity (prematurely). In such cases, banks will pay lesser interest rate than that was decided at the time of deposit.

Pinku: Why should I opt for an FD Dadaji when my savings account also pays me interest?

Dadaji: Ah! Wonderful question Pinku… I really appreciate your intelligence… The answer is very simple my son… FD gives you more interest than the interest given for the savings account.

What is a Recurring deposit Dadaji?

Dadaji : Pinku, Recurring deposit popularly known as RD account is a special kind of deposit suitable for people who do not have lump sum amount of savings, but are ready to save a small amount every month. RD's earn interest on the amount already deposited (through monthly installments) at the similar rates as are applicable for Fixed Deposits. Recurring Deposit accounts usually mature in the range from 6 months to 120 months.

Recurring Deposits are the best small amount savings method

That's not all Pinku, FD's and RD's are also called as Time Deposits as you can withdraw from these accounts only after the maturity or total time period agreed by you with the bank. Though you can withdraw prematurely, the rate of interest you get is less than what you would get if you would have got the amount at maturity of FD or RD.

Pinku: Are there any other kinds of accounts banks might provide?

Accounts can be managed from anywhere

Dadaji: Yes my son… Banks in India provides various other accounts for NRI's and PIO's. Rupee accounts available are NRO (Non Resident Ordinary) and NRE (Non Resident External) accounts. Foreign currency accounts are available in the form of FCNR (Foreign Currency Non Resident) account. Additionally, Demat Accounts are provided for convenience in trading and PPF (public provident fund) account for long terms savings.

Pinku: Who is an NRI Dadaji?

Dadaji: My Son, a Non Resident Indian (NRI) (as per India's Foreign Exchange Management Act 1999 FEMA), is an Indian citizen or Foreign National of Indian Origin living outside India; if his stay in India is less than 182 days during the preceding financial year for employment or business (Lawyer/Doctor/Software engineer).

Pinku: Aha! I got it that's the reason mother calls Bantu Chachu (Uncle) NRI as he resides in New York. Then who is a PIO Dadaji?

Dadaji: PIO means a person of Indian origin. That means that person is not a citizen of India and is deemed to be of Indian origin (except Pakistan or Bangladesh) if:

NRI/NRO/FCNR are accounts for Non-Residents

- ⇒ He at any time held an Indian passport; or
- ⇒ He or either of his parents or any of his grandparents was a citizen of India by virtue of the Constitution of India or Citizenship Act, 1955; or
- ⇒ A spouse (not being a citizen of Pakistan or Bangladesh) of an Indian citizen or of a Person of Indian Origin.

Pinku: I got it Dadaji… So a PIO is not Indian national but some other national (except Pakistan or Bangladesh) who has some roots/ connections in India.

Dadaji: That's right Pinku.

Pinku: Very interesting Dadaji… now let me know what NRO account is?

Banks can send your monies anywhere

Dadaji: My Son… An NRO account is a savings and fixed (/term) deposit account held in India that helps NRIs manage income earned in India such as rent, dividends, or pension flowing in on regular basis and have to make local payments regularly. Foreign currency deposited into the NRO account is converted into Indian Rupees. Any repatriation (money transfer to other countries) done through this account should be reported to RBI. RBI has made some restrictions on NRO accounts. You can remit only up to USD 1 million in a financial year (April to March). In addition, you will need a chartered accountant to complete the paperwork for you.

Pinku: I don't understand that figures Dadaji but one thing I understood is NRO account is useful for those who wants to manage their India earning being there abroad.

Dadaji: Yo!..Yo!… Correct Pinku… Now let me explain you what is NRE Account?

An NRE account is a savings or Fixed (/term) deposit account held in India that allows the account holder to repatriate funds that come from outside earnings and transfer earnings to India conveniently. Money transferred to an NRE account from any foreign currency is converted to INR. It permits an NRI to hold and maintain foreign currency earnings in INR. The account holder may repatriate all the funds along with the interest earned at any point of time without having to pay tax on the interest amount. You can transfer funds from NRE to NRO account. However, the reverse is not allowed.

NRE Account is in INR

Pinku: I got it all. So NRE account is for sending money from abroad to save money in our local currency i.e., Indian Rupee (/INR). If required for any expenses abroad the same can be transferred back and without tax cut… WoW!

Dadaji: Hmm… so your banking brain is starting to think Pinku… Good to note that. Let me now explain you some of the features of the two accounts?

- NRE accounts are tax exempted. Therefore, income taxes, wealth taxes, and gift taxes do not apply in India.

Being abroad, you can maintain rupee a/c

Interest earned from these accounts is also exempt from taxes. But as per Indian Income tax laws, NRO accounts are taxable; income taxes, wealth taxes, and gift taxes do apply. Interest earned on an NRO account as also subject to taxation. You can deposit funds from a foreign country (in foreign currency) in both NRE and NRO accounts, but funds originating from India (in Indian rupees) can only be deposited in an NRO account and cannot be deposited in an NRE account.

- Withdrawals from both NRE and NRO accounts can only be made in INR. An NRE account allows you to transfer funds to another NRE account as well as to an NRO account. You can transfer funds from an NRO to another NRO account, but you cannot transfer funds from an NRO account to an NRE account.

- Two NRIs can open both "an NRE joint account or an NRO joint account". However, you cannot open an NRE joint account with a resident Indian. This facility is available only with an NRO joint account. NRO savings account, would get a domestic debit card which can be used for cash withdrawals in India and for use at merchant locations in India. International debit card is not issued for NRO accounts because funds in NRO account are not freely repatriable/transferrable.

NRO Accounts are not freely repatriable

Pinku: I cannot remember all that you said Dadaji… I can correlate stating that if I am going abroad, I will open NRO account with my mother (Joint account) for my mother to use money sent by me. And If I want money to be saved for myself or to have regular transaction with my Indian NRI friend, will open NRE self/ joint account as the situation may be…

Dadaji: Yes Pinku… But don't forget the basics both accounts are opened in Indian Rupee (/ INR). Now let me explain you how I can save my savings in foreign currencies. For that I will be requiring an FCNR Account.

Pinku: FCNR… What is an FCNR account Dadaji?

Provident Fund works on compounding

NRI's (and PIO's) fear that by investing in India, they are exposed to Foreign Exchange Risk as they would have to convert their investment in Indian currency at the time of investment and then again into foreign currency at the time of withdrawal. The foreign exchange rates at the time of investment and at the time of repatriation may differ thereby exposing them to foreign exchange risk. To ensure that NRI's are not exposed to such forex risk, the Indian Govt. has allowed NRI's (and PIO's) to invest in India in foreign currency itself through FCNR account which stands for Foreign Currency Non Resident Bank Account wherein they can maintain fixed deposit in foreign currency. Major currencies such as US dollars, Great Britain Pound, Euro, AUD, CAD and Japanese Yen are covered.

Pinku: Fantastic Dadaji... Bankers are not only intelligent but help us solve our problems.

Dadaji: Yes Pinku... You are right... let me now explain you what a demat account is...

Demat account is offered to those customers who wants to trade in shares and securities online. Securities are held electronically in a DEMAT Account, thereby eliminating the need for physical paper certificates. Bank makes profit on Depositary charges on this account.

PPF scheme is for long term requirement

Pinku: Let's now understand what is PPF Dadaji..

Dadaji: My son, Public Provident Fund (PPF) scheme is a popular long term investment option backed by Government of India which offers safety with attractive interest rate and returns that are fully exempted from Tax. Investors can invest minimum Rs. 500 to maximum Rs. 150,000. Those who are risk averse can invest in PPF. PPF works on the logic and power of compound interest i.e., the principal amount + interest amount is reinvested every year till the maturity of the fund.

Pinku: I understood Dadaji... PPF investment is done looking at the future requirements such as higher education or marriage or sponsoring foreign education.

You can save valuables in a bank locker

Pinku: My mother was saying to father yesterday to bring gold from bank locker from the bank. What is a bank locker Dadaji?

Dadaji: My Son… Bank Lockers have been the first choice to safeguard valuables such as gold, silver or other precious ornaments or documents or certificates so on and so forth for most Indians, and they continue to be the safest option. To hire a bank locker, you need to be above 18 years of age. Some bankers may also ask you to open a savings account with them. The lockers provided are of different sizes and we can choose the size of the locker based on our requirement. The deposit amount and the charges for hiring the locker vary from bank to bank. The banks have made the nomination or joint ownership of a locker compulsory while hiring a locker. The customer will receive a 'memorandum of letting', which is a document that states our locker details while hiring the locker.

Each locker has two keys: the customer keeps one key, while the other stays with the bank.

The locker can be opened only when both keys are used.

In gold loan the gold itself is the collateral/security

Pinku: Hmm… I see but the other day father was telling to get gold loan from bank. What is that arrangement Dadaji…?

Dadaji: My son Gold Loan as the name suggests is the loan given against gold. Many nationalized banks, private banks and other financial companies offer this loan at attractive rates. Many go for this loan for short period to meet the requirement of their children's education, marriage and other financial problems in the family. And others think that instead of keeping the gold idle at home or locker, loan against gold is the best option.

Pinku: Does bank even sells gold Dadaji?

Dadaji: Yes… Gold has been traditionally the popular investment for Indians. In fact, India, even today is amongst the largest buyers of Gold in the world, followed closely by Silver.

You can purchase gold/silver from banks

In keeping with the traditional investment sentiment, Banks with its 'Pure Gold' and 'Pure Silver' offer attempts in fulfilling this need of our esteemed customers. Gold is available in various denominations from 0.5g till 100g and silver is available in 50g, 100g so on and so forth.

Pinku: Can “I” open an account in a Bank Dadaji?

Dadaji: Why not my son… all the minors can open accounts with bank. A savings /fixed / recurring bank deposit account can be opened by a minor of any age through his/her natural or legally appointed guardian such as your father who is your natural guardian Pinku. Banks are free to offer additional banking facilities like internet banking, ATM/ debit card, cheque book facility etc., subject to the safeguards that minor accounts are not allowed to be overdrawn.

Pinku: Can an illiterate open a banking account?

Dadaji: Illiterate can open accounts in bank. They must attend in person and affix their thumb impression on the account opening form in the presence of an approved witness, who is known both to the bank and the applicant. Such illiterate depositor should lodge their recent photograph with the bank, duly attested by a person known to the bank. Thus, they need not have thumb impression attested by a witness every time they withdraw money from the account. It will suffice, if they affix thumb impression in the presence of an officer of the Bank. Illiterate also has option of withdrawing money through ATM. It’s the duty of the Bank officials to teach the illiterate about operations related to banking and ATM.

Illiterate can not only open account but also use ATM

Pinku: How to open account in a bank Dadaji?

Dadaji: It’s very simple Pinku, you need to fill in account opening forms which will have your basic information such as your address details, your telephone numbers, Nominee details etc… and the annexure of all the proof of documents that you have submitted towards fulfillment of KYC.

Banks manage ac's on risk based approach

Pinku: What documents we need to submit to the bank Dadaji...

Dadaji: You need to produce Identity proof such as PAN Card or Adhar Card or Voter ID Card etc... and address proof such as current bill or gas bill or passport etc...

Pinku: And what is KYC Dadaji?

Dadaji: KYC Stands for "Know Your Customer". Know your customer (KYC) policy is an important step developed by banks to prevent identity theft, financial fraud, money laundering and terrorist financing. Your personal details are sought in the KYC form as what is your name, address, contact numbers, your mother's maiden name, your source of funds i.e., from where you get all your monies from, your occupation details i.e., where you work and all such other details. The objective of KYC is to enable banks to know and understand their customers better and not only help them manage their risks prudently but also sell banking products as per their needs.

Pinku: Dadaji...you have used several big... big... terms can you explain each of the above.

KYC prevents identity theft

Dadaji: Sure Pinku... they are not big terms, they are simple to understand. Let's understand each of them separately.

Identity theft mean someone else posing like you who has all your personal details such as your address, your e-mail address, your contact numbers, your occupation details. That person or imposter based on your personal information gains access to your account and start using your account for his benefits.

Pinku: It's cheating Dadaji... how can someone else use my money by imposing me... that's not correct Dadaji...

Dadaji: That's the reason you should never share your personal details, your pin for accessing your debit/credit cards to anyone even if someone calls to you and tells that they are from bank. Pinku remember one thing "Bankers will never ask for your passwords"... Now let's understand what Financial Fraud is?

Transaction monitoring is to curb frauds

Financial fraud can be broadly defined as an intentional act of deception (misleading) involving financial transactions for purpose of personal gain. The word intentional is very important here Pinku as you are doing a crime knowing very well that it is a crime. Many fraud cases involve complicated financial transactions and people who are well educated who are white collars such as business professionals with specialized knowledge help criminals doing fraud.

Pinku: People who are educated who have knowledge on banking or business or law helping criminals and they themselves involving in frauds and crime. How bad it is Dadaji…

Dadaji: Yes Pinku… all students like you and professionals like your father should not get involved in any kind of fraud let it be the most simplest form of fraud such as cheating in your exams or your father taking a bribe. Never… Never…Never… Let's now understand what is money laundering.

Money laundering refers to a financial transaction scheme that aims to conceal the identity, source, and destination of illicitly-obtained money. People obtain illicit or bad money through various means such as taking bribe, involving in corruption, betting, insider trading (passing on the information that is known to you being in authority in a company to a third party for personal gain) and etc. In simple terms, money laundering is conversion of illicitly earned money (black money) to legitimate money (white money) by doing series of transactions with the Bank.

Professionals should not help financial fraud

Pinku: That's very bad Dadaji…

Dadaji: Correct Pinku but people do it… now let's understand what terrorist financing is?

You remember the September 11, 2001 attacks where a series of four coordinated terrorist attacks by terrorist group al-Qaeda happened in USA. Where do you think this terrorist gets funds from? There are of course several means but majority of them get through our own financial streams and especially banks.

FIU-IND is our financial intelligence

Banks unknowingly can pass on the financing for terrorists. Hence, banks should know their customers very well and should do business with only those customers whom they trust. You can know your customer very well only through KYC. Hence, KYC is strong defense force for the banks.

Pinku: I got it Dadaji. So banks should not only deal with customers whom they know very well but also should monitor their transactions regularly.

Dadaji: Correct Pinku… In banking terms, monitoring transactions of customers is called "Transaction Monitoring". And where ever banks become suspicious of any transactions will inform Financial Intelligence Unit of India so that the criminals/ people encouraging the criminal/illicit activities can be curbed.

Pinku: That's a wonderful step Dadaji… but who are FIU's?

Dadaji: My Son… Financial Intelligence Unit – India (FIU-IND) was set by the Government of India vide O.M. dated 18th November 2004 as the central national agency responsible for receiving, processing, analyzing and disseminating information relating to suspect financial transactions. FIU-IND is also responsible for coordinating and strengthening efforts of national and international intelligence, investigation and enforcement agencies in pursuing the global efforts against money laundering and related crimes. FIU-IND is an independent body reporting directly to the Economic Intelligence Council (EIC) headed by the Finance Minister.

FIU is watching every transaction of yours, fraudsters beware!

Pinku: Oh! They are like CID's for our Country. Hmm…I heard that even Banks are fined for wrong doing is it correct?

Dadaji: Yes Pinku… Banks can be fined for any violation of rules from RBI. I remember this case happened in 2013.

The State Bank of India along with 21 state-owned and private banks, including a foreign one, were fined between Rs.50 lakh and Rs.3 crore (totalling Rs49.5 crore) by the RBI.

Banks avoid fines by being vigilant

for violating customer identification and anti-money laundering norms. The central bank had started probing the banks following a sting operation by online magazine "Cobrapost" in March, which showed videos of bank officials helping customers convert black or untaxed money into white.

Apart from the 22 banks which were fined, the RBI issued cautionary letters to six foreign banks and one public-sector bank where it did not find any norm violations.

Pinku: Aha! That means if rules are not followed strictly, they can be penalized.

Dadaji: Correct Pinku... Banks should follow customer identification procedures and anti-money laundering laws strictly. The Prevention of Money Laundering Act, 2002 (PMLA) forms the core of the legal framework put in place by India to combat money laundering. PMLA and the Rules notified there under came into force with effect from July 1, 2005. Director, FIU-IND (Financial Intelligence Unit, India) and Director (Enforcement) have been conferred with exclusive and concurrent powers under relevant sections of the Act to implement the provisions of the Act.

PMLA is an act for preventing Money Laundering

The PMLA and rules notified there under impose obligation on banking companies to verify identity of clients, maintain records and furnish information to FIU-IND as and when . PMLA defines money laundering offence and provides for the freezing, seizure and confiscation of the proceeds of crime.

Pinku: What are the types of banks Dadaji:

Dadaji: Hmm... Let's now learn different types of Bank Pinku:

Major types of banks are Retail Banks which concentrate on individuals like you and me, Commercial Banks concentrating on business and corporate and Investment Banks for customers interested in trading (both individual and corporate). Some large banks have combination of all the business.

All Banks are regulated by RBI

In India, you have following types of banks:

1) Public-sector banks: Public Sector Banks (PSBs) are banks where a majority stake i.e. more than 50% of shares is held by Government of India. The shares of these banks are listed on stock exchanges.

2) Private Sector Bank: These are the banks where greater parts of shares are held by the private shareholders mainly promoters of the Bank and not by government.

3) Foreign banks: Are those banks which are not incorporated (/born) in India. There are two types of foreign banks namely foreign banks with branches in India and foreign banks with representative offices in India.

4) Regional Rural Banks (RRBs): Regional Rural Banks have been created with a view to serve primarily the rural areas of India with basic banking and financial services. However, RRB's have branches set up for urban operations and their area of operation may include urban areas too.

5) Cooperative banks: These banks are owned by their customers (who has same thinking/ ideologies or want to serve their communities at large) and follow the cooperative principle of one person, one vote. All banking activities of the cooperative banks are regulated by a shared arrangement between RBI and NABARD and all management and registration activities are managed by RCS (Registrar, Cooperative Society). There are different types of cooperative banks in India namely Urban Cooperative Banks, State Cooperative Banks and Rural Cooperative Banks.

Public Sector banks are held more than 50% by Government

6) Development Banks: The main objective of the development bank is to develop the infrastructure of the country. Example of development banks are NABARD (National Bank for Agriculture & Rural Development), EXIM Bank (Export & Import Bank of India), NHB (National Housing Bank), SIDBI (Small Industries Development Bank of India)

Pinku: That was a great learning Dadaji...

Interests and fees are banks' income

I heard something scheduled and non- scheduled banks as well what are those?

Dadaji: Here you go Pinku… A scheduled bank is eligible for loans from the Reserve Bank of India at bank rate. They are also given membership to clearing houses. As a definition, refers to a bank which is listed in the 2nd Schedule of the Reserve Bank of India Act, 1934. Even Cooperative banks are allowed to seek scheduled bank status if they satisfy certain criteria of RBI. The banks not under 2nd Schedule of the Reserve Bank of India Act, 1934 are non- scheduled banks.

Pinku: Great Dadaji… while explaining public sector banks you mentioned something called nationalized bank. What is nationalized Bank Dadaji?

Dadaji: Nationalization is the process of bringing privately owned banks directly under the control of government. Post-independence in 50's most of the commercial banks was in private sector then. These private banks could not help Government towards its Socio-Economic objectives. Thus, the government decided to nationalize 14 major commercial banks

Nationalization is the process of bringing private banks under govt. control

on 19th July, 1969. All commercial banks with a deposit base over Rs.50 Crores were nationalized.

Pinku: There are so many Banks in India…Is there someone who controls banks Dadaji?

Dadaji: Depending on countries, banks are regulated/controlled either directly by the Central government or Central Bank. In India all banks are controlled by the central bank of India which is RBI (Reserve Bank of India).

Pinku: Back to basics Dadaji…How does bank make money?

Dadaji: There are three main ways banks make money which are: by charging interest on money that they lend, by charging fees for services they provide and by trading/giving services related to financial instruments in the financial markets.

Pinku: Wow…! Dadaji so simple…

Dadaji: No my son not as simple as it appears.

Cheques are safest mode of transactions

Banks needs to trust customers and customers need to trust banks than only this is possible. Bank, day in and day out, face the risk of defaulters or non-payers for the loan they take.

Pinku: How can I withdraw my money from the bank Dadaji?

Dadaji: The simplest way for withdrawing money is through ATM (/Automated Teller Machines). You can also visit the branch of your bank and withdraw money using a Cheque.

Pinku: There are lots of ATM's of different Banks I see while I go to school Dadaji. Can I withdraw money in any Bank ATM Dadaji?

Dadaji: Yes my son you can withdraw money from any Bank ATM. However, each bank restricts transaction in ATM with other banks and also self-bank. Beyond certain number of transactions, you are liable to pay additional charges for using the ATM services.

Pinku: What are the other things you can do in ATM Dadaji?

Dadaji: My son... not only withdrawal, you can also deposit money, transfer money, change your pin and change your mobile number through ATM's. Now let's understand a Cheque.

A Cheque is a negotiable Instrument

Pinku: Cheque...??? What is a Cheque Dadaji?

Dadaji: A Cheque is a negotiable instrument an order to a bank to pay a specific amount of money. Money from your account to the person in whose name the Cheque has been issued or you can also, draw a self Cheque for withdrawal.

Pinku: Dadaji what is a negotiable instrument?

Dadaji: A negotiable instrument is a document guaranteeing the payment of a specific amount of money, either on demand, or at a set time, with the payer named on the document. More specifically, it is a document contemplated by or consisting of a contract, which promises the payment of money without condition, which may be paid either on demand or at a future date as per the terms of the document.

Pinku: Aah... I got it Dadaji...

Cheques are negotiable instruments

So Cheque is an agreement between “the issuer” (the drawer or the person who writes the Cheque) “the bank” (who promise to pay bearing in my mind account of the drawer has sufficient balance) and the payee (/beneficiary) of the Cheque.

Dadaji: Hmm... perfect Pinku... Bingo... Now I will tell you the forms by which a Cheque can be drawn?

There are three forms by which a Cheque can be drawn Bearer Cheque, order Cheque and crossed Cheque.

When the words "or bearer" printed on the Cheque is not cancelled, the Cheque is called a bearer Cheque. A bearer Cheque is made payable to the bearer i.e. it is payable to the person who presents it to the bank for encashment. However, such Cheques are risky; this is because if such Cheques are lost, the finder of the cheque can collect payment from the bank. Bearer Cheque can be transferred by mere delivery; they need no endorsement.

When the word "or bearer" printed on the Cheque is cancelled and the word ‘order’ may be written on the Cheque, the Cheque is called an order Cheque. An order Cheque is one which is payable to a particular person. The payee can transfer an order Cheque to someone else by signing his or her name on the back of it.

> A crossed Cheque cannot be cashed at bank counter

Crossing of Cheque means drawing two parallel lines on the left corner of the Cheque with or without additional words like "Account Payee Only" or "Not Negotiable". A crossed Cheque cannot be cashed at the cash counter of a bank but it can only be credited to the payee’s account. This is a safer way of transferring money.

Pinku: Ah... so among all the forms of writing a Cheque a bearer Cheque has most risk as any one carrying this Cheque becomes of the owner of the Cheque. If you want to draw a Cheque on some account just cross the Cheque and the amount will land in the account and you cannot withdraw money in branch counter. What are the other things that I should remember Dadaji?

Do not accept bearer Cheque

Dadaji: Pinku the things which we should remember are as given below.

a) When a Cheque is not crossed, it is known as an "Open Cheque" or an "Uncrossed Cheque". These Cheques may be cashed at any bank and the payment of these Cheques can be obtained at the counter of the bank or transferred to the bank account of the bearer.

b) Cheque in which the drawer mentions the date earlier than the date on which it is presented to the bank, it is called as "anti-dated Cheque". Such a Cheque is valid up to six months from the date of the Cheque.

c) Cheque on which drawer mentions a future date to the date on which it is presented, is called post-dated Cheque. Banks do not accept Post-dated Cheques.

d) If a Cheque is presented for payment after six months from the date of the Cheque it is called stale Cheque. After expiry of that period, no payment will be made by banks against that Cheque.

e) When a Cheque is torn into two or more pieces and presented for payment, such a cheque is called a mutilated Cheque. The bank will not make payment against such a Cheque without getting confirmation of the drawer.

A torn Cheque is called Mutilated Cheque

f) In the bottom of the Cheque, you will have numbers written. The first set of numbers relate to the Cheque number (usually 6 digits). The second set of number represents MICR code (9 digits). The third set of number represents account code (6 digits) and the final set of numbers (2 digits) represent transaction code.

g) MICR code written on the Cheque has following relevance. The first three number represents City code, the next three numbers are Bank code (i.e., which bank has issued the Cheque to the account holder) and the last three number represent Bank Branch code (i.e., location of branch of that bank). MICR code is used by RBI or clearing bank for clearing process.

Pinku: Oh my goodness Dadaji... All these days I was thinking a Cheque to be a simple plain paper.

Cheques are negotiable instruments

From today I will not meddle with my dads Cheque book.

Dadaji: Good my boy now you know how important it is to deal and store a Cheque safely to avoid any damages. Now I will tell you about the different types of Cheques.

a) Local Cheque: A local Cheque is valid in a particular city. The Cheque in whose name it is issued can directly go to the designated bank and receive the money in the physical form. If a given city's local Cheque is presented elsewhere shall attract some fixed banking charges. Although these types of Cheques are still prevalent, especially with nationalized banks, it is slowly being removed with at par Cheque type.

b) At par Cheque: At par Cheque is a Cheque which is accepted at par at all its branches across the country. Unlike local Cheque it can be present across the country without attracting additional banking charges.

c) Bankers Cheque: A Bankers Cheque is issued by the Bank payable to the order of specified payee for payment within a local area. All Bankers Cheques are "NOT NEGOTIABLE". To be issued for use only within the clearing area of the issuing Bank and if cleared outside the clearing area then the normal outstation Cheque commission is payable. Bankers Cheque should be accepted as good by the payee as it has been paid for by the customer at time of issue. It cannot be returned except for technical reasons. Usually is used by customers who do not have a current account but wish to make payments by Cheques or in situations when a personal Cheque is unacceptable.

Travelers Cheque is a bearer Cheque handle carefully

Travelers Cheque: It's kind of an open type bearer Cheque issued by the bank which can be used by the user for withdrawal of money while touring. Travelers Cheque is always worthwhile; taking some of our foreign exchange in travelers Cheques is safe as it is a great backup to cash and cards. The beauty of Travelers Cheques is that they can be replaced if they are lost or stolen.

Banks are constantly innovating for you

It always helps if one keeps a record of travelerscheque number if need to make a claim for lost Cheques. Furthermore, it does not have validity. Hence, one can save any unused Travelers Cheques for future purpose. Do you know, similar to the travelers Cheque banks also offer travel cards in the currency denomination which you want. If you are travelling to UK, you can carry GBP currency travel card and so on and so forth.

Gift Cheque: It's a unique mode to present your gifts to our near and dear ones on all occasions. Payable at par at all branches of the bank. This is another banking instrument introduced for gifting money to the loved ones instead of hard cash.

Pinku: Wow Dadaji… Gift Cheque reminds of my school giving a gift card to Chantu… what is that Dadaji.

Dadaji: My Son, as you are aware, banks have become smarter the way they want to serve their customers. Hence, they have come up with innovative idea of a gift card which is a simple debit card that allows the cardholder to use it for the purchase of goods or services. These cards are preloaded with requisite amount. The cards become useless after you have purchased the equivalent amount that was preloaded in the card.

A Cheque is cleared through a clearing house

Pinku: Gottcha Dadaji.

Dadaji: Somewhere you have deviated from what we were discussing. Anyway now I will explain you how is a Cheque cleared…

A) The Payee deposits the Cheque with his bank. If the payee (or beneficiary) of Cheque has an account in the same bank from where the Cheque has been drawn by the drawer the funds are credited into his account through internal transfer of funds (provided the funds are available in the drawers bank account).

B) If the payee (or beneficiary) has an account with any other bank in the same or in any other city, then his banker would ensure that funds are collected from the payer's banker through a clearing house.

Banks are constantly innovating for you

Pinku: Aha...What is a clearing house Dadaji?

Dadaji: Each bank sends its representative to a centralized place called the clearing house to exchange Cheques drawn on each other. The Reserve Bank of India acts as a clearing house. Where RBI is not present, the State bank of India and other public sector banks act as clearing houses.

Pinku: How are the funds (/monies) settled by the clearing house Dadaji?

Dadaji: The value of Cheques presented by a bank on other banks represents the claim by that bank. Similar claims are made by all the banks on every other bank in the clearing. Each of the member bank maintains a current account with the clearing house. A net settlement is arrived at the clearing house and the debit or credit position of the bank is determined. These are booked in their current accounts maintained by the settling bank. This represents the inter- bank settlement.

Pinku: What about the Cheques which are not valid for some reason like signature not matching or insufficient funds in the drawers account.

A bounced Cheque is a bad Cheque that cannot be honored

Dadaji: Such Cheques are returned to the drawee bank. The presenting bank account is credited with the equivalent amount with the clearing house and drawee bank account debited. In turn the drawee bank returns the Cheque to the drawer of the Cheque with reasons. The drawee bank (i.e. where the drawer has an account) charges drawer for the outward return Cheque and the presenting bank where the Cheque was deposited by the payee (i.e. where the payee has account) charges payee (/beneficiary of the Cheque) for the inward return Cheque. However, most of the banks do not charge for technical reasons. These could be mismatch in signature, no date mentioned on the Cheque or if the Cheque is a post-dated.

Pinku: Ah..! I understand debiting some charges for drawer for the mistake he must have done. But, why the payee has to pay for something that is not his/her mistake.

Handle Cheques carefully to avoid fines

Dadaji: Bull's-eye! Fantastic question my dear… The answer is straightforward and simple it's the processing charges for the Cheque. Here I wish to tell you that the outstation Cheques are sent by post for collection to the representative branch or correspondent branch for presentation in the clearing house in the outstation center. Once the Cheque is realized, the proceeds are remitted to the original presenting bank for credit to the customer account. I have already told you how local Cheques are cleared.

Pinku: Why in this fast moving world still our banks are carrying physical Cheques to the clearing house. Such a waste of time and man hours.

Dadaji: You are right Pinku. Hence, Cheque Truncation System (CTS) or Image-based Clearing System (ICS), in India, is a project undertaken by the Reserve Bank of India (RBI) in 2008, for faster clearing of Cheques. CTS is based on a Cheque truncation or online image-based Cheque clearing system where Cheque images and Magnetic Ink Character Recognition (MICR) data are captured at the collecting bank branch and transmitted electronically. Cheque truncation means stopping the flow of the physical Cheques issued by a drawer to the drawee branch. The physical instrument is truncated at some point en route to the drawee branch and an electronic image of the Cheque is sent to the drawee branch along with the relevant information like the MICR fields, date of presentation, presenting banks etc. This would eliminate the need to move the physical instruments across branches, except in exceptional circumstances, resulting in an effective reduction in the time required for payment of Cheques, the associated cost of transit and delays in processing, etc. ., thus speeding up the process of collection or realization of Cheques.

Image based Clearing is faster than normal clearing

Pinku: Hmm… Great… I have heard in school something on speed clearing what is that Dadaji?

Dadaji: Speed clearing refers to collection of outstation Cheques (a Cheque drawn on non-local bank branch) through the local clearing.

Cheques are cleared on same day today

It facilitates collection of Cheques drawn on outstation core-banking-enabled branches of banks, if they have a net-worked branch locally. Banks have networked their branches by implementing Core Banking Solutions (CBS). In CBS environment, Cheques can be paid at any location obviating the need for their physical movement to the Drawee branch. Cheques drawn on outstation CBS branches of a Drawee bank can be processed in the Local Clearing under the Speed Clearing arrangement if the Drawee bank has a branch presence at the local center. As on date, the local Cheques are processed on T+1 working day basis and customers get the benefit of withdrawal of funds on a T+1 or 2 basis. 'T' denotes transaction day viz. date of presentation of Cheque at the Clearing House. So, the outstation Cheques under Speed Clearing will also be paid on T+1 or 2 basis like any other local Cheque.

Pinku: That is too much of information you have provided Dadaji. To understand it in simple speed clearing enables outstation Cheque to clear same as a local Cheque due to branch networking of the banks.

Clearing process consists of Inward clearing and Outward clearing

Dadaji: My God Pinku… Good job… appreciate it… let's now understand what is inward and outward clearing?

Cheques received by the branch from various banks for debiting their customers accounts of the branch is called inward clearing.

Cheques deposited by the customers sent for clearing to the respective banks is called outward clearing.

Pinku: Too complicated Dadaji… Cheques received by our bank for debiting our account is called inward clearing and Cheques sent by our bank for collection for crediting our account is outward clearing right Dadaji…

Dadaji: Oh… Fantastic explanation Pinku. Yes you are absolutely correct.

Pinku: Thank you Dadaji. Can you now throw some light on what is a credit card?

Dadaji: Yes sure Pinku here you go…

Cheques are cleared on same day today

A credit card is a plastic card with a magnetic stripe that holds a machine readable code. The card gives the convenience to purchase our needs (such as goods in supermarkets, Petrol in Petrol Stations etc., where Credit Card machine has been installed). Bank based on card holders account history and credit worthiness sets a limit on the card. The user can use amount up to the limit set on the card. One can use the credit card for purchases as well withdraw cash from ATM's in case of emergencies.

Pinku: What is the advantage of a credit card Dadaji?

Dadaji: When you use your credit card on merchant outlet or online for buying something you get a grace period which is called an interest free credit period. You have to pay back to the bank within the grace period. You are enjoying interest free credit within this grace period. Usually the grace period is given for 45 days.

Pinku: hmm... so banks are giving me free credit for 45 days correct Dadaji.

Dadaji: Partially correct Pinku... you will be levied an interest of 2.5% or more per month as per the issuer bank norms in case if you are not repaying the credit used. A late fee charge will also attract if you are unable to pay within the billing date. Presently in India, banks can charge late fees only in the next billing cycle following a missed payment.

Interest free period is the free credit period

Pinku: Oh my god Dadaji... that's the reason so many people say don't use credit card without proper knowledge.

Dadaji: Yes my son... you have to further know that Bank usually gives two options for making payment. Minimum balance amount or full amount. If you are paying minimum balance amount or any higher amount which is less than the full payment within the billing cycle, interest is still levied on the remaining outstanding amount.

Pinku: Hmm... Dadaji what if I withdraw cash using credit card?

Remember the billing date of credit card

Dadaji: That is still more risky Pinku. When you withdraw cash from credit card, right from the day one you have to pay interest which ranges between 24 to 48 percent per annum on that advance amount that you have withdrawn.

You have two choices to pay this amount, either minimum balance amount or full amount. If you are unable to pay minimum amount due, you have to pay late payment charges which maybe 30 percent of the outstanding balance. Apart from that if you are not paying the full amount you are paying that interest, which is 24 -28 percent per annum. Also the grace period which is applicable for your other transactions, if the full amount is not repaid before due date then you do not get any grace period and you have to pay interest on the new purchase from the day one.

Pinku: I will never use Credit card Dadaji.

Dadaji: No No my son... You understood me wrong. As you are now aware how to use credit card and within what period, I think credit card is a good source of immediate funds Pinku. For the convenience of customers, bank also gives option of converting the loaned money to pay back in installment. You just need to pick your mobile and inform them that you need to convert the purchases made into installments. That's it... it's so simple.

A merchant is one who accepts credit cards

Pinku: Who are the players involved in credit card Dadaji?

Dadaji: Here is the details son

Cardholder

A cardholder is someone who obtains the credit card from a card issuing bank. They then present that card to merchants as payment for goods or services.

Merchant

A merchant is any business that maintains a merchant account that enables them to accept credit cards as payment from customers (cardholders) for goods or services provided.

Acquiring Bank (Merchant Bank)

Card associations settle CC payments

An acquiring bank is a registered member of the card associations (Visa and MasterCard). An acquiring bank is often referred to as a merchant bank because they contract with merchants to create and maintain accounts that allow the business to accept credit and debit cards, (i.e. merchant accounts). Acquiring banks provide merchants with equipment and software to accept cards, promotional materials, customer service and other necessary aspects involved in card acceptance. The acquiring bank also deposits funds from credit card sales into a merchant's account.

Issuing Bank (Cardholder Bank)

As you've probably guessed, an issuing bank issues credit cards to consumers. The issuing bank is also a member of the card associations (Visa and MasterCard).

Card Associations (Visa and MasterCard)

Visa and MasterCard aren't banks and they don't issue credit cards or merchant accounts. Instead, they act as a custodian and clearing house for their respective card brand.

Issuing banks issue credit cards to customers

The primary responsibilities of the Card Association are to govern the members of their associations, including interchange fees and qualification guidelines, act as the arbiter between issuing and acquiring banks, maintain and improve the card network and their brand, and, of course, make a profit. That last one has become even more important now that Visa and MasterCard are public companies.Visa uses their VisaNet network to transmit data between association members, and MasterCard uses their Banknet network.

Pinku: Oh Dadaji I never knew so many people involved in the transaction of a credit card. Can you explain me in brief what happens in the back ground of a credit card?

Dadaji: Why not… A cardholder begins a credit card transaction by presenting his or her card to a merchant as payment for goods or services.

Creditcard transactions are instantaneous

The merchant uses their credit card machine, software or gateway to transmit the cardholder's information and the details of the transaction to their acquiring bank, or the bank's processor. The acquiring bank (or its processor) captures the transaction information and routes it through the appropriate card network to the cardholder's issuing bank to be approved or declined. MasterCard transaction information is routed between issuing and acquiring banks through MasterCard's Banknet network. Visa transactions are routed through Visa's VisaNet network. The credit card issuer receives the transaction information from the acquiring bank (or its processor) through Banknet or VisaNet and responds by approving or declining the transaction after checking to ensure, among other things, that the transaction information is valid, the cardholder has sufficient balance to make the purchase and that the account is in good standing. The card issuer sends a response code back through the appropriate network to the acquiring bank (or its processor). The response code reaches the merchant's terminal, software or gateway and is stored in a batch file awaiting settlement.

Card issuing bank pays the acquiring bank for its cardholder's purchases

A merchant begins the settlement process by sending their batch of approved authorizations to their acquiring bank (or the bank's processor). Authorization batches are typically sent at the close of each business day. The acquiring bank (or its processor) reconciles and transmits the batch of authorizations through interchange via the appropriate card association's network (VisaNet or Banknet).The acquiring bank also deposits funds from sales into the merchant's account via the automated clearinghouse (ACH) and debits its merchant's account for processing fees either monthly, daily or both depending on the merchant's processing agreement. The card association debits the issuing bank's account and credits the acquiring bank's account for the net amount of the authorizations which is gross receipts less interchange and network fees. The card issuing bank essentially pays the acquiring bank for its cardholder's purchases.

Pay loans through ECS

The cardholder is responsible for repaying his or her issuing bank for the purchase and any accrued interest and fees associate with the card agreement.

Pinku: Oh Dadaji… you give so much of explanation that it is very tough for me to remember.

Dadaji: It's very easy Pinku and very similar to cheque clearing. Here the Visa/Master card just acts like a central bank. There are only two steps involved authorization of Card and settlements of monies.

Pinku: If I wish to make repeated transactions every month what should I do?

Dadaji: Banks accept written standing instructions (SI) from the customer. As per the instruction every month on the fixed date banks make the payments as per your instructions. Examples include paying premiums of your Life insurance, paying rents, mortgages etc.

Pinku: Is it not the same as an ECS /Electonic Clearing Service?

Dadaji: The confusion between standing Instruction and ECS is long running and completely understandable.

Pay premiums through standing instructions

Both are instructions to your bank to make payments, usually on a regular basis, to a third party. The difference is subtle but important. With standing instructions, you are giving your bank an instruction to pay a certain individual/ institution's bank account a set sum at regular intervals - monthly, weekly, quarterly or annually.

The sum cannot change unless you cancel the existing instruction and set up a new one. It generally takes around three working days for the money to arrive in the recipient's bank account and the process is not free banks charge for the services.

However, in an ECS an authorization is taken from a customer to allow a particular institution to collect sums from his/her bank account, provided that institution gives advance notice of the collection times and amounts. Usually there are no charges associated with ECS.

Beware of Bank charges

Pinku: Aha… So standing instruction I am giving order to make payment to an institution or individual. However, in ECS, I am allowing an institution or individual to collect money from my bank account.

Dadaji: Yes my son… ECS are cheaper for institutions so they naturally favor them over standing Instructions and also the payment is instant. Standing instruction may take two to three days. Now a day's banks charges for its services that you may not even know until you have a steady look at your bank statement.

Pinku: What are these charges Dadaji?

Dadaji: For instance your savings bank account includes charges for demand drafts, for not maintaining minimum balance in the account. Beyond a certain number of branch visits, banks start charging on the transactions done by you. As discussed earlier, they charge for the standing instructions in two ways one for setting the standing instructions and the other for each of the transaction made. Many banks also charge for ATM card replacement in case of loss and pin regeneration in case you forget it. Requests beyond the usual monthly or quarterly account statements entail costs such as Six months statement which may require for applying some kind of loan. Banks charges accounts closed between one month and one year from the date of account opening. Cheques returned without being paid - whether deposited or issued by you – will entail a cost. Similarly, an instruction to the bank to not pay a cheque after issuing it will cost you. Requesting cheque books beyond the allowed quota also carries charges.

Demand Drafts attracts some minimum charges

Pinku: What…? So many charges… oh my god…

Dadaji: Hmm… My son you should know ins and outs regarding your bank. It's always necessary to do sufficient inquires before you open an account. Now let's understand what is a debit card?

A Debit card is similar in size to a credit card. The difference between debit card and credit card is that in debit card, you are not asking for a loan from the bank

instead you are using your own money in your savings account for making purchases at merchant outlets or online.

Pinku: How does a debit card work?

Dadaji: Exactly similar to a credit card a two leg process authorization and settlement of accounts.

Pinku: What should I do if I lose Debit/Credit Card? And when my cheque book is fully utilized from where can I get the same?

Dadaji: The first thing when you lose your card is to call up call center and block your cards so that no other person who has stolen your card or got your card can withdraw money from it. The next step is to request your card with the bank. You can do it in three ways, request the call center, or visit a branch and give your request or you can order the same online. Similarly, Cheque books also can be ordered through call center or branch or online through internet banking.

Pinku: Ok Dadaji I got it... Online banking seems to be convenient way of banking. Also I heard, several people use internet or online banking. Can you throw some light on this Dadaji?

Instantaneous money transfers are available online

Dadaji: Oh yes! My son... there are so many services that are available through internet banking. You can transfer funds to other's accounts, you can pay bills, you can invest in mutual funds, and you can even donate for a good cause online.

Pinku: Oh that's great Dadaji... can you throw some light on each of the services you mentioned above.

Dadaji: Yes my son why not... In funds transfer services, you can transfer money from your account to any other account of the same bank, to any other bank account using NEFT/RTGS, to the same bank or any other bank using Immediate Payment services also called IMPS. Let's now talk about each of the services separately.

Same Bank account transfer: As the entire branch networks are connected

Neft is cleared in batches hence, slow

you can easily transfer funds from your bank account to your own account or any other same bank account instantly. Bank simply debits your account and credits the same bank account through internal transfer.

Other Bank account transfer: As the entire banks are not connected to each other via a single network, the transfers from one bank account to the other happen through either NEFT or RTGS.

Pinku: Aha... so let's understand step by step Dadaji please explain what is NEFT?

Dadaji: My son the full form of NEFT is National Electronic Funds Transfer is an Indian system of electronic transfer of money from one bank or bank. In order to make a remittance via NEFT, the customer initiating the transfer needs to have the IFSC (Indian Financial System Code) of the bank branch where the beneficiary account is located.

As we have discussed in previously Pinku, the IFSC code identifies the bank and branch of the bank.

Pinku: Why people say that NEFT takes time and not instantaneous.

IFSC identifies the branch of a bank

Dadaji: Oh my boy... you know this... good Pinku. Yes you have heard it right. Usually the transfer happens on the same day and not instantly as this is a "net" transfer facility which is executed in hourly batches resulting in a time lag. To understand better let me explain you the whole process.

The originating bank branch prepares a message and sends the message to its pooling center or the NEFT Service Centre. The pooling center forwards the message to the NEFT Clearing Centre (operated by National Clearing Cell of Reserve Bank of India) to be included for the next available batch.

The Clearing Centre sorts the funds transfer transactions destination bank-wise and prepares accounting entries to receive funds from the originating banks (debit) and give the funds to the destination banks (credit).

RTGS suites high value transactions

Thereafter, bank-wise remittance messages are forwarded to the destination banks through their pooling centre (NEFT Service Centre). The destination banks receive the inward remittance messages from the Clearing Centre and pass on the credit to the beneficiary customers' accounts. As you are aware, NEFT operates in hourly batches - there are twelve settlements from 8:00 AM to 7:00 PM on week days and six settlements from 8:00 AM to 1:00 PM on Saturdays. Any transaction initiated after a designated settlement time would have to wait till the next designated settlement time. No transactions are settled on weekly holidays and public holidays.

Pinku: Why you always explain to me with full-fledged details and confuse me. It's so simple Dadaji the National clearing cells debits the originating banks and credits the destination banks in batch runs.

Dadaji: I explained you in detail so that it's clearly understood. See how you could explain yourself a complex process in just a single step.

Pinku: OK Dadaji now can we move on to RTGS.

RTGS is a real time settlement

Dadaji: Yes Pinku... The acronym 'RTGS' stands for Real Time Gross Settlement. Here the monies are settled instantly and there is no physical exchange of money. The RTGS payment is directly controlled by RBI.

The RBI makes adjustments in the electronic accounts of Bank A and Bank B. Bank A's (Originating Bank) account is debited and Bank B's (Destination Bank) account is credited with the same amount. The RTGS system is suited for low-volume, high-value transactions.

Pinku: All that is fine Dadaji but how to originate the transactions.

Dadaji: Hmm... Good question Pinku... You can do RTGS/NEFT transfers online by adding a beneficiary. You need to fill an online application providing details such as name of the beneficiary, bank name, branch name, IFSC code, account type (Savings/Current) account number.

MMID is Mobile money identifier

Once registered, you can transfer funds to the beneficiary. Both NEFT and RTGS work based on the IFSC codes entered. The systems transfer money by identifying the IFSC code. Once you register a payee, you can do transfer through ATM's also.

Pinku: Dadaji… you were talking about some IMPS what it is?

Dadaji: Yes good that you reminded… IMPS/ Immediate payment Service by which you can transfer funds instantaneously avoiding any waiting time. It can be done using either your mobile or internet. In mobile, you can download the bank application provided by your bank (For e.g., I mobile app by ICICI Bank) where in funds transfer section you enter beneficiary's mobile number and 7 digit MMID following the amount that you want to transfer. After you submit, further authentication is asked such as grid values in your debit card and the payment is done to the beneficiaries account. Similarly, you can generate MMID through net banking and authenticate through grid values of your debit card and make payments to the beneficiary. In order to receive fund, you need to

Bank Mobile Apps are convenient to use

share your mobile number and MMID with whom you wish to receive the payment. There are also similar products used by banks such as pocket wallets to transfer funds.

Pinku: That's wonderful Dadaji, payments are becoming easy and mobile through latest app/ mobile technologies. Let's get forward can you tell me how to pay bills Dadaji?

Dadaji: It's still simple Pinku, just add your billers online and start paying the bills.

Pinku: Wow! Avoid standing in lines and pay bill within seconds. Hmm… let's now understand how to invest in mutual funds?

Dadaji: The details of the mutual funds are given in respective bank sites. You can download the forms online, fill the form and submit it to your nearest Branch of the bank.

Pinku: Oh… similar to above we can also donate online through net banking right Dadaji.

HNI's get preferred services at banks

Dadaji: Absolutely Pinku…

Pinku: Dadaji, I have a very basic question are all customers treated the same way.

Dadaji: Fantastic question Pinku. Usually general banking is same for all customers. However, banks also offer wealth management services to its customers. These services are offered to the Premier/High Net worth Individuals (popularly known as HNI's) who are very wealthy and require assistance to manage their wealth. Such customers will have a Relationship Manager who will be their single point of contact for all their banking and investment needs. Some banks also offer dedicated Customer Service Manager at the branch to ensure they get priority service and quick solutions, making their banking experience smoother and more convenient. Usually, the Relationship Manager is supported internally by a team of experts who bring with them knowledge and experience in say Loans, Investments and Properties.

Pinku: what is overdraft facility given by the banks Dadaji?

> Overdraft is the bonus given by banks to it's loyal customers

Dadaji: Hmm… The word overdraft means the act of overdrawing from a Bank account. In other words, the account holder withdraws more money from a Bank Account than has been deposited in it. Overdraft facility is a credit given to an individual against his or her assets as collateral with banks. Some of the banks also provide OD facility for the salary accounts (such as 3 times of the salary or more). As collateral, you can offer following assets to banks: house, insurance policies, bank fixed deposits, shares and bonds, etc. However, interest rates charged and overdraft sanctioned by banks vary on each of the collateral.

Pinku: I understood Dadaji. However, you said interest changes depending on the collaterals or security that has been kept with the bank. Can you explain that in detail.

Dadaji: Oh sure Pinku… here you go…

Using your house as collateral:

You can get OD's over your salaries too

Bank does a valuation and survey of the property, then sanction an overdraft limit of up to 50% to 60% considering value of the property, your credit history and repayment capacity. However, this amount will not be disbursed immediately. It works like an approved loan and you are eligible to keep withdrawing amount from this overdraft account when required. You are eligible to pay interest rate from the time this overdraft is availed and amount withdrawn. The rates of interest for loans against property range between 12% & 14% p.a.

Using banks fixed deposits as collateral:

On fixed deposits, you are eligible to get higher percent of amount sanctioned (approx 70%) as overdraft facility compared to home as collateral. Also, interest rates charged by banks are lower compared to house as collateral. While taking overdraft against fixed deposits, banks charge one percent more than the interest rate payable on fixed deposit scheme. Consider, your fixed deposit is earning 9% interest income p.a. then you will be paying out 10% interest cost p.a. for the period you avail the overdraft.

Using your insurance policy as collateral:

> Overdraft is usually charges 1% more than FD rate

On life insurance policy, you are eligible to get higher percent of amount sanctioned as overdraft, compared to house as collateral. The amount for overdraft is calculated on surrender value of life insurance policy.

Using equity as collateral:

Stock prices are volatile to market and economy of the country. So, it's considered as a risky asset class for overdraft. Banks consider equity as collateral for overdraft, but percent sanctioned against current market price of stocks is lower.

Overdraft against your salary:

Banks offer temporary overdraft facility against your monthly salary. The amount depends on the individual banks providing the loans.

Pinku: Dadaji... so many things you have covered under a simple topic of OD... Really amazing...

Dadaji: Yes Pinku... Banking itself is very exciting.

Letter of credits comes with a cost

Now let me tell you how banks does non-fund based services for business.

Pinku: Non fund based you mean without involving money… exciting please tell Dadaji.

Dadaji: Non Fund based as the name suggests, bank gives credit facilities where actual bank funds are not involved. These facilities include Letter of Credit, Bank Guarantee, LC Advising / Confirming Services, Bancassurance.

Pinku: That's easy Dadaji… but can you explain each of the credit facilities you have mentioned.

Dadaji: Sure Pinku let us start with Letter of credit and LC advising/confirming services.

The importer or buyer arranges for the issuing bank to open a Letter of Credit in favor of the exporter or seller. The issuing bank transmits the Letter of Credit (LC) to the advising bank (exporters banker who advises the exporter) which forwards it to the exporter.

The exporter forwards the goods and documents to a freight forwarder. The freight forwarder dispatches the goods and submits documents to the advising bank. The advising bank checks documents for compliance with the Letter of Credit and pays the exporter. The importer's account at the issuing bank is debited as per the arrangement between issuing bank and advising bank. The issuing bank releases documents to the importer to claim the goods from the carrier. In Letter of Credit transactions, banks deal in documents only, and not goods.

A Letter of credit is a credit letter

Further, Pinku Letter of Credits can be issued as revocable or irrevocable. Most LC's are irrevocable, which means they may not be changed or cancelled unless both the buyer and seller agree. If the LC does not mention whether it is revocable or irrevocable, it automatically defaults to irrevocable.

Revocable LC's are occasionally used between parent companies and their subsidiaries conducting business across borders.

Pinku: Dadaji, you use too many technical terms which I don't understand.

Bank guarantee is a contractual obligation

What I understood is bank has no role but to have trust built between international buyers and sellers through documents.

Dadaji: Perfect! Pinku you got it all. Now let us understand Bank Guarantee.

A bank guarantee is a promise from a bank that if a particular borrower defaults on a loan, the bank will cover the loss. There are two types of guarantees a financial guarantee and a performance guarantee.

Let us take an example Pinku to better understand the Bank Guarantee. Let's assume your fathers company is dealing with much larger entity or even a government across border. Let us assume your fathers company has won a project from say the Government of Hong Kong to build Roads.

In this case, companies all over the world would have applied. The selection would be made on the basis of lowest cost and track record as submitted in the proposal form.

However, the government has limited ability to assess all companies for financial stability and credit worthiness. To ensure the project is done satisfactorily and on time, the government puts a condition that all companies will have to furnish a guarantee given by one or more banks.

> A bank Guarantee is it's promise to make good the payment to Beneficiary

Your fathers company needs to give a Bank Guarantee that it has the capability to do the project, on winning the bid. This ensures only serious bidders are in the fray for the project. This is called a bid-bond guarantee.

In banking nomenclature, your fathers company is an applicant, its bank is the issuing bank and the Government of Hong Kong is the beneficiary. Usually, the Bank Guarantee is for a specified amount, which is a percentage of the total money required for the contract. Obviously, the bank will not just issue such guarantee with its own due diligence. The bank does its own thorough analysis of the financial wellbeing of your fathers company to assess the amount of guarantee it can issue. After all, the bank is at a risk too, in case the client defaults.

Bank guarantee is a form of security

This amount is called a limit. Here too there is a catch. The bank will issue guarantee provided the company has not exceeded its overall limit for Bank Guarantees.

And if the Government of Hong Kong is not satisfied with the performance of the contract at a later date, it can invoke the Bank Guarantee. In this situation, the bank will have to immediately release the amount of the Guarantee to the government.

Pinku: Oh so the Bank does not give the whole amount… hmm… it only gives part of the contract as Bank Guarantee to help win the bid.

Dadaji: Yes Pinku correct. Also, Bank Guarantees are broadly classified into Performance and Financial Bank Guarantees.

As the name suggests, Performance Bank Guarantees are the ones by which the issuing bank, also known as the Guarantor, guarantees the ability of the applicant to perform a contract, to the satisfaction of the beneficiary and on agreed time.

Financial Guarantee – This type of guarantee is given by the bank to the creditor on behalf of debtor that debtor will pay his or her debt to the creditor on time and in the event of default made by the debtor, bank will compensate to the credit for the loss due to failure of repayment by the debtor.

Bank Guarantees comes with limits

Let us continue with our earlier example, to secure the project even further, the Government of Hong Kong might insist on stage payment guarantees. This would have milestones like 20 percent, 40 per cent, etc and a period in which these have to be done. As and when your fathers company does that part of the work, the Bank Guarantees would expire, thus freeing its limits with the bank.

Your fathers company also might be getting an advance payment for buying materials, etc. Again, it will have to furnish a Bank Guarantees to the extent of the advance, called an advance payment Bank Guarantees.

CRR and the SLR defines home loans

Pinku: Hmm… so the bank guarantees the winner of the bidder at every stage of the project till the project is completed. Let's continue to understand what Bancassurance is.

Dadaji: Bancassurance is the partnership or relationship between a bank and an insurance company whereby the insurance company uses the bank sales channel to sell insurance products to the bank's client base.

Pinku: Understood Dadaji… I have read in paper that RBI controls economy of our country… how is that possible Dadaji.

Dadaji: Good question Pinku. Yes RBI not only regulates banks but also controls our economy. To understand this better first we need to understand what are CRR, SLR, Repo Rate, and Reverse repo rate.

CRR means Cash Reserve Ratio. Commercial Banks in India are required to hold a certain proportion of their deposits (both demand and time) in the form of cash.

Banks hold this proportion in their current account maintained with RBI. The total deposits to be held as cash is stipulated by the RBI and is known as the CRR or Cash Reserve Ratio. The CRR is maintained fortnightly average basis. Usually CRR is 4%; it means, when a bank's deposits increase by Rs 100, and if the cash reserve ratio is 4%, the banks will have to hold additional Rs 4 with RBI and Bank will be able to use only Rs 96 for investments and lending / credit purpose. Therefore, the higher the ratio (i.e. CRR), the lower is the amount that banks will be able to use for lending and investment.

> CRR is the min. amt. to be maintained by commercial bank with central bank

This power of RBI to reduce the lendable amount by increasing the CRR is a tool used by RBI to control liquidity in the banking system.

Pinku: Aha… I got it Dadaji so that means the more the CRR the less can a bank lend and invest. But Dadaji… the money held by banks is in current account maintained by them with RBI. That means they will not get any interest on this amount correct?

Dadaji: Bingo! Pinku... you are absolutely correct. Now let us understand what is SLR?

Statutory liquidity ratio refers to the amount that the Commercial Banks are required to invest a certain percentage of their time and demand deposits in assets specified by RBI, including gold, and government bonds and securities. The SLR ratio has been in a range of 23-25% for the past 10 years. Banks usually keep more than the required SLR, and at present, the actual SLR stands at 21.5%. RBI wants banks to hold a part of the money in near cash so that they can meet any unexpected demand from depositors at short notice by selling the bonds.

In case of a lower SLR, the banks have higher amount to give as credit which means that more people will now take loans for various purposes. Since credit becomes available at a lower rate of interest and puts money in the hand of the people, the demand for goods rises. This may lead to inflation, when people have more cash in their hands than the goods produced in the market. Similarly, in case of a higher SLR, banks have less money to lend, they will now lend at a higher rate of interest. This helps in curbing inflation. But it also slows down the economy.

> Repo rate is the rate at which the RBI lends money to commercial banks

Pinku: What is inflation Dadaji?

Dadaji: The definition of Inflation is sustained increase in the price of goods and services. If you look at the above example the purchasing power is gradually increasing thus increasing the demand of goods thus increasing the price of goods. This is inflation.

Pinku: Ah... now I understand... That means SLR controls the inflation.

Dadaji: You caught the point my boy... now let's understand what a Repo rate is...

Repo rate is the rate at which the Reserve Bank of India lends money to commercial banks in the event of any shortfall of funds. Repo or repurchase option is a means of short-term borrowing, wherein banks sell approved government securities to RBI and get funds in exchange.

Interest rates are > than repo rates

Banks always charges interest which is higher than the existing repo rates to its customer who are availing loans. In case the repo rates are lower, that means bank affords to lend its customer at a cheaper rate and Vice Versa.

Pinku: So you mean to say that repo rate changes can affect the borrowing rate.

Dadaji: Correct Pinku… When repo rate is high Banks are compelled to pay higher interest to the RBI which in turn prompts them to raise the interest rates on loans they offer to customers. The customers are discouraged in taking credit from banks leading to a shortage of money in the economy and less liquidity. So, while on the one hand, inflation is under control as there is less money to spend; growth suffers as companies avoid taking loans at high rates leading to a shortfall in production and expansion.

Pinku: Interesting Dadaji… Iam liking it… please continue with reverse repo rate.

Dadaji: Sure my son…Reverse repo is the exact opposite of repo. In a reverse repo transaction, banks purchase government securities form RBI and lend money to the banking regulator, thus earning interest. Reverse repo rate is the rate at which RBI borrows money from banks. Banks are always happy to lend money to RBI since their money is in safe hands with a good interest. Thus, repo rate is always higher than the reverse repo rate.

> Reverse repo rate is rate at which RBI borrows money from commercial banks

Pinku: Wow Dadaji… So I guess even reverse repo rate changes can effect economy correct… but I am unable to understand how?

Dadaji: It’s very simple Pinku… If there is an increase in the Reverse Repo, Banks would be willing to deposit more money with RBI for good returns. The banks themselves extend this increase of rates to customers by increasing deposit rates. The customers enticed by the increased deposit rate deposit more money in the banks thus sucking out liquid money from the market and reducing the inflation. Decreasing Reverse Repo will obviously have the reverse effect i.e. the deposit rates are reduced.

CDO's are bundling of bank loans

Pinku: What banks do when they have excess liquid assets above and beyond the liquidity requirements?

Dadaji: That's fantastic question Pinku… Pinku Do you know even banks borrow or lend to each other… The interbank lending market is a market where banks extend loans to one another for a specified term. As you are aware, Banks are required to hold an adequate amount of liquid assets, such as cash, to manage any potential bank runs by clients. If a bank cannot meet these liquidity requirements, it will need to borrow money in the interbank market to cover the shortfall. Those Banks who have excess liquid assets above the liquidity requirements lend this money with interest rate called interbank interest rate. Usually banks borrow or lend in interbank lending market for short terms for say a day (also called overnight lending or borrowing) or a week.

Pinku: Dadaji why did some Banks find themselves in Financial Trouble?

Dadaji: Ah! I need to tell you something called subprime effect which led to financial recession all over the world. The U.S. subprime mortgage crisis was a nationwide banking emergency that coincided with the U.S. recession of December 2007 – June 2009.

Securities backed by mortgages are called MBS

For many years leading up to 2007, interest rates were very low in USA and money was cheap. Hence, for Banks to prosper, they needed to lend as much as they could if they were going to make profits. So banks in the USA started lending to all segments of the customers including those who were called subprime customers whose chance of paying back their loans was very less than the banks traditional customers.

To manage the risk, banks invented new and complex ways to lend. As loans are debts to bank, they also invented new ways to package up these debts. The expansion of household debt was financed with mortgage-backed securities (MBS) and collateralized debt obligations (CDO). This involved the bundling of bank loans to create tradable bonds.

Bad loans mean more defaulters

This allowed these debts to be spread out to other banks including foreign banks, so they did not feel so exposed to the risk. Eventually no one really knew who was lending what to whom.

The subprime who has taken loans against their homes could not pay them back. As they defaulted, their houses were taken from them by the Bank and sold.

By the time banks realized, most of loans were already sold to subprime. As they could not pay, more houses went for sale, the prices stopped rising and began to drop.

Suddenly banks realized that many of the loans they had made might not be paid back. However, because of the complex nature of modern lending, they had no idea how many of these loans they had.

They also had no idea which other banks had a lot of bad debt. So they became very cautious about lending to one another in the interbank market. Immediately some banks found themselves in deep trouble, because they depended upon the lending between banks to keep solvent from day to day.

Lack of planning from banks often end them up in bankruptcy

Hence, Banks always need to think and rethink before they lend and also before they accept deposits.

Pinku: I agree Dadaji... I will also be cautious and do my timely home-works so that I don't face failure in examinations.

Pinku: So Dadaji Banks can also die... correct...?

Dadaji: Yes Pinku in technical terms banks can become bankrupt. There are several reasons for bankruptcy.

Mostly this happens due to lack of planning by the banks or promoter of the bank pressurizing bank to invest where returns are unlikely to come or banks can even go become bankrupt through rumors.

As discussed in previous session, if bank starts accumulating bad loans that is defaulters, it has direct effect on its depositors who lose trust with the bank and start withdrawing their monies.

Negative news on bank mean trust breach

A small bad news against the bank can also lead a bank to bankruptcy, customers of the bank will squeeze the liquidity (through withdrawals from ATM or Online transfers or by removing the deposits prematurely) of the bank to so much extent that it files bankruptcy.

Pinku: Dadaji… that was a great journey of whole banking system. Thanks for all the knowledge Dadaji.

Dadaji: You are welcome my dear. That was my pleasure sharing with you what I knew… if something has gone wrong during this journey hope you will correct with what is latest.

Pinku: Yes Dadaji… Always will update myself… Good Night Dadaji…

Dadaji: Good night Pinku My Son…

Banks are built on Trust

The bank has been there and will be there till the term finance or managing finance is prevailing

Thank

You