BANKING, FINANCIAL SERVICES & BUDGET

Meaning of Bank:
An organization, usually a corporation, chartered by a state or federal government, which does most or all of the following: receives demand deposits and time deposits, honors instruments drawn on them, and pays interest on them; discounts notes, makes loans, and invests in securities; collects checks, drafts, and notes; certifies depositor's checks; and issues drafts and cashier's checks.

Functions of RBI

- Monetary authority
- System of Note issue
- Regulator and supervisor of the financial system
- Prescribes broad parameters of banking operations within which the country's banking and financial system functions.
- Manager of exchange control
- Manages the Foreign Exchange Management Act
- Issuer of currency
- Issues and exchanges or destroys currency and coins not fit for circulation.
- Developmental role
- Performs a wide range of promotional functions to support national objectives.

Banking Terms

- **Non Performing Assets (NPAs):**
  Advances are classified as standard assets and non-performing assets
  Standard assets: Standard Asset is a performing asset with interest and principal being serviced properly.
  Non-performing assets (NPAs): A standard asset becomes non-performing when it ceases to generate income for the bank i.e., interest and/or installment of principal remain overdue for a period of more than 90 days.
- **PLR-** means primary lending rate...The interest rate that commercial banks charge their best, most credit-worthy customers. Generally a banks best customers consist of large corporations. The rate is determined by the Federal Reserves decision to raise or lower prevailing interest rates for short-term borrowing. Though some banks charge their best customers more and some less than the official prime rate
- **What is sub prime lending-** Sub Prime Lending is lending at a higher rate than the Prime Rate. Type of Loan offered at Rate above Prime to individuals who do not qualify for Prime Lending Rate loans. A subprime loan is offered at a rate higher than Business loans due to the perceived increased risk. Subprime lending includes a variety of credit instruments, including subprime mortgages, subprime car loans subprime credit cards etc
- **Base Rate System** is for the banks to set a level of minimum interest rates charged while giving out the loans. This Base Rate System has many advantages over the older method of Prime Lending Rate (PLR). One advantage is, in the Prime Lending Rate (PLR), one could sanction the loan for lower price for the preferred customer or the corporate bodies and retail customers may have to pay more for the same type of loans. In the base rate system, there will not be much variance on the loans.
- **Bank rate** is also called as the discount rate. It is the rate of interest which a central bank charges on the loans and advances provided to commercial banks.
- **Net Liquidity Ratio**: measure of a firm's ability to meet maturing short-term obligations, measurement of a business entity's liquidity,
- **Open market operations** are the means of implementing monetary policy by which a central bank controls its national money supply by buying and selling government securities, or other financial instruments. Monetary targets, such as interest rates or exchange rates, are used to guide this implementation.
- **CRR:** Cash Reserve Ratio is a bank regulation that sets the minimum reserves each bank must hold to customer deposits and notes. Cash reserve Ratio (CRR) in India is the amount of funds that the banks have to keep with RBI. If RBI decides to increase the percent of this, the available amount with the banks comes down. RBI is using this method (increase of CRR rate), to drain out the excessive money from the banks.

- **SLR:** Every bank is required to maintain at the close of business every day, a minimum proportion of their Net Demand and Time Liabilities as liquid assets in the form of cash, gold and un-encumbered approved securities. The ratio of liquid assets to demand and time liabilities is known as Statutory Liquidity Ratio (SLR).
- **Selective credit controls :**
  Selective credit controls are meant to regulate the terms on which credit is granted in specific sectors. They seek to control the demand for credit for different uses by
  a) determining down payments
  b) Regulating the period of time over which the loan is to be repaid.
- **Moral Suasion:** It means advising, requesting and persuading the commercial banks to co-operate with the central bank in implementing its general monetary policy. Through this method, the central bank may request the commercial banks not to grant loans for speculative purposes.
- **Repo Rate**: (Repurchase) rate is the rate at which the RBI lends shot-term money to the banks. When the repo rate increases borrowing from RBI becomes more expensive. Therefore, we can say that in case, RBI wants to make it more expensive for the banks to borrow money, it increases the repo rate; similarly, if it wants to make it cheaper for banks to borrow money, it reduces the repo rate
- **Reverse Repo Rate:** The reverse repo rate is the rate at which banks park their short-term excess liquidity with the RBI. The RBI uses this tool when it feels there is too much money floating in the banking system. An increase in the reverse repo rate means that the RBI will borrow money from the banks at a higher rate of interest. As a result, banks would prefer to keep their money with the RBI.
- **Monetary policy:** is the process by which the government, central bank, or monetary authority of a country controls (i) the supply of money, (ii) availability of money, and (iii) cost of money or rate of interest, in order to attain a set of objectives oriented towards the growth and stability of the economy Monetary policy is referred to as either being an expansionary policy, or a contractionary policy, where an expansionary policy increases the total supply of money in the economy, and a contractionary policy decreases the total money supply. Expansionary policy is traditionally used to combat unemployment in a recession by lowering interest rates, while contractionary policy involves raising interest rates in order to combat inflation

- **Fiscal Policy**

  How Fiscal Policy Works
  This theory basically states that governments can influence macroeconomic productivity levels by increasing or decreasing tax levels and public spending. This influence, in turn, curbs inflation (generally considered to be healthy when at a level between 2-3%), increases employment and maintains a healthy value of money.
  Let's say that an economy has slowed down. Unemployment levels are up, consumer spending is down and businesses are not making any money. A government thus decides to fuel the economy's engine by decreasing taxation, giving consumers more spending money while increasing government spending in the form of buying services from the market (such as building roads or schools). By paying for such services, the government creates jobs and wages that are in turn pumped into the economy. Pumping money into the economy is also known as "pump priming". In the meantime, overall unemployment levels will fall.
  With more money in the economy and less taxes to pay, consumer demand for goods and services increases. This in turn rekindles businesses and turns the cycle around from stagnant to active.

- If, however, there are no reins on this process, the increase in economic productivity can cross over a very fine line and lead to too much money in the market. This excess in supply decreases the value of money, while pushing up prices (because of the increase in demand for consumer products). Hence, inflation occurs.
- And When The Economy Needs To Be Curbed…
- When inflation is too strong, the economy may need a slow down. In such a situation, a government can use fiscal policy to increase taxes in order to suck money out of the economy. Fiscal policy could also dictate a decrease in government spending and thereby decrease the money in circulation. Of course, the possible negative effects of such a policy in the long run could be a sluggish economy and high unemployment levels. Nonetheless, the process continues as the government uses its fiscal policy to fine tune spending and taxation levels, with the goal of evening out the business cycles.

Non Banking Financial Institutions
A non-banking financial company (NBFC) is a company registered under the Companies Act, 1956 and is engaged in the business of loans and advances, acquisition of shares/stock/bonds/debentures/securities issued by government or local authority or other securities of like marketable nature, leasing, hire-purchase, insurance business, chit business, but does not include any institution whose principal business is that of agriculture activity, industrial activity, sale/purchase/construction of immovable property.

A non-banking institution which is a company and which has its principal business of receiving deposits under any scheme or arrangement or any other manner, or lending in any manner is also a non-banking financial company (residuary non-banking company).

Non -banking Financial Institutions carry out financing activities but their resources are not directly obtained from the savers as debt. Instead, these Institutions mobilise the public savings for rendering other financial services including investment. All such Institutions are financial intermediaries and when they lend, they are known as Non-Banking Financial Intermediaries (NBFIs) or Investment Institutions.

Difference between NBFC & Banks
NBFCs perform functions similar to that of banks; however there are a few differences in that an NBFC cannot accept demand deposits; an NBFC is not a part of the payment and settlement system and as such, an NBFC cannot issue cheques drawn on itself; and deposit insurance facility of the Deposit Insurance and Credit Guarantee Corporation is not available for NBFC depositors, unlike banks.

Insurance Sector

An Overview

Insurance business is divided into two classes:
Life Insurance General Insurance

Life Insurers transact life insurance business. General Insurance includes fire, marine and other miscellaneous insurances. No composites are permitted as per law.

The business of Insurance essentially means defraying risks attached to any activity over time (including life) and sharing the risks between various entities, both persons and organisations. Insurance companies (ICs) are important players in financial markets as they collect and invest large amounts of premium. Insurance products are multi purpose and offer the following benefits :

1. Protection to the investors
2. Accumulate savings
3. Channelize savings into sectors needing huge long term investments.

Insurance is defined as the equitable transfer of the risk of a loss, from one entity to another, in exchange for a premium, and can be thought of a guaranteed small loss to prevent a large, possibly devastating loss.
- An insurer is a company selling the insurance.
- The insurance rate is a factor used to determine the amount, called the premium, to be charged for a certain amount of insurance coverage.
- Risk management, the practice of appraising and controlling risk, has evolved as a discrete field of study and practice.

Some information on IRDA
Insurance Regulatory & Development Authority is regulatory and development authority under Government of India in order to protect the interests of the policyholders and to regulate, promote and ensure orderly growth of the insurance industry. It is basically a ten members' team comprising of a Chairman, five full time members and four part-time members, all appointed by Government of India. This organization came into being in 1999 after the bill of IRDA was passed in the Indian parliament.

Powers and Functions of IRDA

- It issues the applicants in insurance arena, a certificate of registration as well as renewal, modification, withdrawal, suspension or cancellation of such registrations.
- It protects the interests of the policy holders in any insurance company in the matters related to the assignment of policy, nomination by policy holders, insurable interest, and resolution of insurance claim, submission value of policy and other terms and proposals in the contract.
- It also specifies obligatory credentials, code of conduct and practical instructions for mediator as well as the insurance company. Apart from this, it also defines the code of conduct for the surveyors and loss assessors involved with the insurance business.
- One of the major functions of IRDA includes endorsing competence in the insurance business. Apart from this, upholding and regulating professional organizations in insurance and re-insurance business is also a major duty of IRDA.

Types of Business Organisations in India

The principal forms of business organization in India are:
Companies – both public and private
Partnerships
Sole proprietorships

Companies incorporated in India and branches of foreign corporations are regulated by the Companies Act, 1956 (the Act)

(a) Types of Companies

A company can be a public or a private company and could have limited or unlimited liability. A company can be limited by shares or by guarantee. In the former, the personal liability of members is limited to the amount unpaid on their shares while in the latter, the personal liability is limited by a pre-decided nominated amount. For a company with unlimited liability, the liability of its members is unlimited.
Apart from statutory government owned concerns, the most prevalent form of large business enterprises is a company incorporated with limited liability. Companies limited by guarantee and unlimited companies are relatively uncommon.

(i) Private Companies

A private company incorporated under the Act has the following characteristics:
The right to transfer shares is restricted.
The maximum number of its shareholders is limited to 50 (excluding employees).
No offer can be made to the public to subscribe to its shares and debentures.
Private companies are relatively less regulated than public companies as they deal with the relatively smaller amounts of public money. A private company is deemed to be a public company in the following situations:
When 25 percent or more of the private company's paid-up capital is held by one or more public company.
The private company holds 25 percent or more of the paid-up share capital of a public company.
The private company accepts or renews deposits from the public.
The private company's average annual turnover exceeds Rs. 250 million during a period of 3 consecutive financial years.

(ii) Public Companies

A public company is defined as one which is not a private company. In other words, a public company is one on which the above restrictions do not apply. Regarding the necessary procedures to be followed for registering the company, a flow chart presents the summary of the steps involved in formation of a company with Registrar of Companies.

(iii) Foreign Companies

Foreign investors can enter into the business in India either as a foreign company in the form of a liaison office/representative office, a project office and a branch office by registering themselves with Registrar of Companies (ROC), New Delhi within 30 days of setting up a place of business in India or as an Indian company in the form of a Joint Venture and wholly owned subsidiary. For opening of the foreign company specific approval of Reserve Bank of India is also required.

Debt Market and Equity Market

The debt market is the market where debt instruments are traded. Debt instruments are assets that require a fixed payment to the holder, usually with interest.
Examples of debt instruments include bonds (government or corporate) and mortgages.
The equity market (often referred to as the stock market) is the market for trading equity instruments. Stocks are securities that are a claim on the earnings and assets of a corporation An example of an equity instrument would be common stock shares, such as those traded on the New York Stock Exchange.

How are debt instruments different from equity instruments?

There are important differences between stocks and bonds. Let me highlight several of them:

Equity financing allows a company to acquire funds (often for investment) without incurring debt. On the other hand, issuing a bond does increase the debt burden of the bond issuer because contractual interest payments must be paid— unlike dividends, they cannot be reduced or suspended.

Those who purchase equity instruments (stocks) gain ownership of the business whose shares they hold (in other words, they gain the right to vote on the issues important to the firm). In addition, equity holders have claims on the future earnings of the firm.

In contrast, bondholders do not gain ownership in the business or have any claims to the future profits of the borrower. The borrower's only obligation is to repay the loan with interest.

Bonds are considered to be less risky investments for at least two reasons. First, bond market returns are less volatile than stock market returns. Second, should the company run into trouble, bondholders are paid first, before other expenses are paid. Shareholders are less likely to receive any compensation in this scenario.

Equity Market Basic Terms

Stock
A stock is a small share that represents a partial ownership of a company. Stocks are issued by companies in order to raise capitals and are bought by investors in order to acquire a portion of the company. Even a small share of the company will give the investors the right to have a say

Stock market
It is a term used to describe the physical location where the buying and selling of stocks take place as well as the overall activity of the market within a particular country. The correct term to be used in pertaining to the physical location for trading stocks is "stock exchange." Every country may have a couple of different stock exchanges that are usually traded on only one exchange although a lot of large corporations may be listed in several different locations.

Bull Markets and Bear Markets
A bear market indicates the continuous downward movement of the stock market. Conversely, a bull market indicates the constant upward movement of the stock market. A particular stock that seems to be increasing in value is described to be bullish while a stock that seems to be decreasing in value is described to be bearish.

The bull and bear terms do not refer to the short term fluctuations in the stock market. A bear market is the stock market wherein the prices of the key stocks have fallen by 20% or more over a period of at least two months. Prices, even during a bear market, may temporarily increase. Bull markets, being the opposite of bear markets, indicate a rise in the prices of the key stocks over a certain period of time.

IPO- Initial Public Offering (IPO) in India means the selling of the shares of a company, for the first time, to the public in the country's capital markets. This is done by giving to the public, shares that are either owned by the promoters of the company or by issuing new shares.

During an Initial Public Offer (IPO) the shares are given to the public at a discount on the intrinsic value of the shares and this is the reason that the investors buy shares during the Initial Public Offering (IPO) in order to make profits for themselves.

Mutual Funds

Mutual funds are investment companies that pool money from investors at large and offer to sell and buy back its shares on a continuous basis and use the capital thus raised to invest in securities of different companies.

SEBI

SEBI is the Regulator for the Securities Market in India. Originally set up by the Government of India in 1988, it acquired statutory form in 1992 with SEBI Act 1992 being passed by the Indian Parliament. SEBI has three functions rolled into one body quasi-legislative, quasi-judicial and quasi-executive. It drafts regulations in its legislative capacity, it conducts investigation and enforcement action in its executive function and it passes rulings and orders in its judicial capacity.

Getting Started on the Stock Market

Most stock trading activities are done through an intermediary called a broker. Brokers, who take and execute orders from the investors, can also offer investment advices and analyses to their clients. Such brokers are called full-service brokers and they charge a relatively high commission. The types of brokers that do not offer investment advices to their clients are called discount brokers. Investors who wish to save more money usually hire discount brokers because they charge less commission.

Online trading and broker-assisted trading are two of the most commonly offered services by brokers. There are some brokers who use an Interactive Voice Response System for placing orders via telephones and a Wireless Trading System for making orders via web-enabled cellular phones or other handheld devices.
The 3 basic things needed for getting started are:

* Demat Account
* Trading Account
* Bank Account