<u>Department of Commerce (CA)</u>

ALLIED PAPER-II BANKING THEORY LAW AD PRACTICES.

SEMESTER:II SUB CODE:18BCA25A
B.COM(CA)

UNIT1: Meaning and definition of banking-banking system-role and importance of banks-Commercial bank-functions- Recent trends in Commercial bank.

<u>REFERENCE BOOK:</u>

- BANKING LAW AND PRACTICE- P. N. VARSHNEY
- A TEXT BOOK OF BANKING – RADHASWAMY AND VASUDEVAN
- BANKING THEORY LAW AND PRACTICES- GORDON AND NATARAJAN
- INDIAN BANKING – PARAMESHWARAN AND NATARAJAN
- BANKING THEORY LAW AND PRACTICS- SANTHANAM.

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INTRODUCTION TO BANKING

1. 1. Bank is a business of accepting deposits and lending money. It is carried out by financial intermediaries, which performs the functions of safeguarding deposits and providing loans to the public. Banking Company: Any company, which transacts the business of banking Banking System is a principal mechanism through which the money supply of the country is created and controlled. The banking system enables us to understand Commercial Banks, Secondary Banks, Central Bank, Merchant Bank or Accepting Houses and Discount Houses but to exclude the Saving Banks and Investment and other intermediaries.
2. 2. Meaning of Commercial Bank: A commercial bank is a profit-seeking business firm, dealing in money and credit. It is a financial institution dealing in money in the sense that it accepts deposits of money from the public to keep them in its custody for safety Definitions of Banks: “A bank is a person or corporation which holds itself out to receive from the public, deposits payable on demand by cheque.” ----- Walter Leaf “Bank as a manufacture of credit and a machine for facilitating exchange.” ----- Horace White “A Bank is a financial institution which accepts money from the public for the purpose of lending or investment repayable on demand or

otherwise withdrawable by cheques, drafts or order or otherwise.” ---- Banking Companies Act of India

3. 3. Dealing in Money Individual / Firm / Company Acceptance of Deposit Giving Advances Payment and Withdrawal Agency and Utility Services Profit and Service Orientation Ever increasing Functions Connecting Link Banking Business

4. 4. Banking in India in the modern sense originated in the last decades of the 18th century Among the first banks were the Bank of Hindustan, which was established in 1770 General Bank of India, established 1786 The largest bank, and the oldest still in existence, is the State Bank of India. It originated as the Bank of Calcutta in June 1806. In 1809, it was renamed as the Bank of Bengal. This was one of the three banks funded by a presidency government, the other two were the Bank of Bombay and the Bank of Madras. The three banks were merged in 1921 to form the Imperial Bank of India, which upon India's independence, became the State Bank of India in 1955

5. 5. Reserve Bank of India was established in 1935, under the Reserve Bank of India Act, 1934. In 1960, the State Banks of India was given control of eight state-associated banks under the State Bank of India (Subsidiary Banks) Act, 1959. These are now called its associate banks. In 1969 the Indian government nationalised 14 major private banks. In 1980, 6 more

private banks were nationalized. These nationalized banks are the majority of lenders in the Indian economy The Indian banking sector is broadly classified into scheduled banks and non-scheduled banks

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

7. 7. In the early 1990s, the then government embarked on a policy of liberalization, licensing a small number of private banks. These came to be known as New Generation tech-savvy banks, and included Global Trust Bank (the first of such new generation banks to be set up), which later amalgamated with Oriental Bank of Commerce, UTI Bank (since renamed Axis Bank), ICICI Bank and HDFC Bank. The new policy shook the Banking sector in India completely. Bankers, till this time, were used to the 4–6–4 method (borrow at 4%; lend at 6%; go home at 4) of functioning

8. 8. Broadly speaking, banks can be classified into commercial banks and central bank. The central bank has the function of controlling commercial banks and various other economic activities. There are many types of commercial banks such as deposit banks, industrial banks, savings banks, agricultural banks, exchange banks, and miscellaneous banks.
9. 9. Public Sector /Nationalized Banks Private Sector Banks (Indian) and Foreign-Commercial Banks in India. Public Sector /Nationalized Banks: State Bank of India
10. 10. The following 7 commercial banks were nationalized and made the Subsidiaries of State Bank of India (4 in the year on 19th July 1960 and 3 on 19th July 1969) : 1.State Bank of Hyderabad (SBH)-Founded by the last Nizam of Hyderabad in the year 1941-(Nationalized in 1960), 2.State Bank of Mysore (SBM)-Established in 1913 as by (late) Dr. M. Visvesvaraya under the sponsorship of the then Government of Mysore 3.State Bank of Patiala (SBP)-Founded on 17th of November, 1917 by His Highness Bhupindar Singh, the Maharaja of the princely state of Patiala 4.State Bank of Saurashtra (SBS) 5.State Bank of Travancore (SBT)-Founded in the year 1945- (Nationalized in 1960), 6.State Bank of Bikaner and Jaipur (SBBJ)-Founded in 1963 at Jaipur- (State Bank of Bikaner founded in 1944 took over the State Bank of Jaipur founded in 1943)- 7.State Bank of Indore

(SBIR)-Founded in the year 1963- (Nationalized in 1969)(merged into SBI in 2008)

11.11. The following 14 Major Commercial Banks were nationalized on 19th July 1969 during the then Prime Minister of India, Mrs.Indira Gandhi:- 1.Allahabad Bank-Founded by a Group of Europeans on 24th April 1865 at Allahabad 2.Bank of Baroda-Founded in the year 1908 in Baroda 3.Bank of Maharashtra-Founded on 16th September 1935 at Pune 4.Bank of India-Founded in September 1906 at Mumbai 5.Canara Bank-Founded on 1st July 1906 at Bangalore 6.Central Bank of India-Founded by Sir Sorabji Pochkhanawala at Mumbai in the year 1911.

12.12. 7. Dena Bank-Founded on 26th May 1938 by Devkaran Nanjee family 8.Indian Bank-Founded on 15th August 1907 as a part of Indian Swadeshi Movement at Chennai (then Madras) 9.Indian Overseas Bank-Founded in the year 1937 at Chennai (then Madras) 10. Punjab National Bank-Founded in Lahore in the year 1894 11.Syndicate Bank -Founded in Udipi in Karnataka in the year 1925 12.UCO Bank-Founded in 1943 by Birla at Kolkata (the then Calcutta) 1 3.Union Bank of India-Inaugurated by Mahatma Gandhi in November 1919 . 14.United Bank of India-Inaugurated by Mahatma Gandhi in November 1919 – nationalized in 1975

13.13. The following 6 Commercial Banks were nationalized in the year 1980: 1.Andhra Bank -Founded in the year 1923 2.Corporation Bank-Founded in the year 1906 at Udupi in Karnataka 3.New Bank of India- Established in the year 1968/Renamed as New India Bank in the year 1977 4.Oriental Bank of Commerce-founded in Februray 1943 at Lahore 5.Punjab and Sind Bank-Founded at Amritsar in the year 1908 6.Vijaya Bank -established by Mr.A.B.Shetty on 23rd October 1931

14.14. The following are the Private Sector Scheduled Banks in India: Axis Bank Bank of Rajastan Bharat Overseas Bank Bassein Catholic Bank Catholic Syrian Bank City Union Bank Development Credit Bank Dhanlaxmi Bank Federal Bank Ganesh Bank of Kurundwad HDFC Bank ICICI Bank IndusInd Bank ING Vysya Bank Jammu & Kashmir Bank Karnataka Bank Karur Vysya Bank Kotak Mahindra Bank Lakshmi Vilas Bank Nainital Bank Punjab Bank Ratnakar Bank Rupee Bank

15.15. Commercial banks have to perform a variety of functions which are common to both developed and developing countries. These are known as ‘General Banking’ functions of the commercial banks. The modern banks perform a variety of functions. These can be broadly divided into two categories: (a) Primary functions and (b) Secondary functions.

16.16. A bank is a business organisation engaged in the business of borrowing and lending money. A bank can earn income only if it borrows at a lower rate and lends at a higher rate. The difference between the two rates will represent the costs incurred by the bank and the profit. Interest on Loans Interest on Investments Discounts Commission, Brokerage, etc.

17.17. The financial position of a commercial bank is reflected in its balance sheet. The balance sheet is a statement of the assets and liabilities of the bank. The assets of the bank are distributed in accordance with certain guiding principles. These principles underline the investment policy of the bank. Liquidity: Profitability Safety or Security Diversity: Saleability of Securities Stability in the Value of Investments Principles of Tax-Exemption of Investments

MODERN BANKING PRACTICES

- INTRODUCTION
- Bank is the main confluence that maintains and controls the "flow of money" to make the commerce of the land possible. Government uses it to control the flow of money by managing Cash Reserve Ratio (CRR) and thereby influencing the inflation level.

- Banking regulation act came in existence in 1949 with numerous provisions which may be classified into two categories: (i) built in safeguards and (ii) power and consequential functions and responsibilities of the Reserve Bank of India. The other important set of provisions pertains to the suspension of business by and winding up of banking companies.

ORGIN OF BANKS

- The word Bank comes from the Italian word ‘Banco” which means bench.
- In the mid ages , the money changers of Italy did their business in the street on a bench. In fact, earlier the temples usually served as the place to deposit money. In Rome in the 210 B.C., an ordinance was issued that set aside a place for money changers.

Banking in India

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

- The largest bank, and the oldest still in existence, is the State Bank of India (S.B.I). It originated and started working as the Bank of Calcutta in mid-June 1806. In 1809, it was renamed as the Bank of Bengal. This was one of the three banks founded by a presidency government, the other two were the Bank of Bombay in 1840 and the Bank of Madras in 1843.

- The three banks were merged in 1921 to form the Imperial Bank of India, which upon India's independence, became the State Bank of India in 1955.
- For many years the presidency banks had acted as quasi-central banks, as did their successors, until the Reserve Bank of India[5] was established in 1935, under the Reserve Bank of India Act, 1934

- **Reserve Bank of India Act, 1934** is the legislative act under which the Reserve Bank of India was formed. This act along with the Companies Act, which was amended in 1936, were meant to provide a framework for the supervision of banking firms in India

- In 1960, the State Banks of India was given control of eight state-associated banks under the State Bank of India (Subsidiary Banks) Act, 1959. These are now called its associate banks.
- In 1969 the Indian government nationalised 14 major private banks, one of the big bank was Bank of India. In 1980, 6 more private banks were nationalised.

- These nationalised banks are the majority of lenders in the Indian economy. They dominate the banking sector because of their large size and widespread networks.
- The Indian banking sector is broadly classified into scheduled and non-scheduled banks. The scheduled banks are those included under the 2nd Schedule of the Reserve Bank of India Act, 1934

- The scheduled banks are further classified into: nationalised banks; State Bank of India and its associates; Regional Rural Banks (RRBs); foreign banks; and other Indian private sector banks.[7] The term commercial banks refers to both scheduled and non-scheduled commercial banks regulated under the Banking Regulation Act, 1949

- The **Banking Regulation Act, 1949** is a legislation in India that regulates all banking firms in India.[1] Passed as the Banking Companies Act 1949, it came into force from 16 March 1949 and changed to Banking Regulation Act 1949 from 1 March 1966. It is applicable in jammu and kashmir from 1956. Initially, the law was applicable only to banking companies. But, 1965 it was amended to make it applicable to cooperative banks and to introduce other changes

- Banking Company means any company which transacts the business of banking in India. Explanation: Any company which is engaged in the manufacture of goods, or which carries on any trade, and accepts deposits of money from the public merely for the purpose of financing its business , shall not be deemed to transact the business of banking within the meaning of this clause.

DEFINITION OF BANK

- Section 5(b) of the BRA 1949, defines Banking as “accepting, for the purpose of lending or investment of deposits of money received from the public, repayable on demand or otherwise, and withdrawable by cheque, draft, order or otherwise” •

COMMERCIAL BANKS

- According to CULBERSTON “Commercial banks are the institutions that make short term loans to business and in the process create money”.
- FUNCTIONS OF CB:
- Primary Functions-Banking Activities
- Secondary Functions- Non-Banking Activities

A. PRIMARY FUNCTIONS

- ACCEPTING DEPOSITS
- Acceptance of deposits is the most important function of commercial banks. They accept deposits in several forms according to requirements of different sections of the society. The main kinds of deposits are:

i.Current Account Deposits or Demand Deposits:

- _These deposits refer to those deposits which are repayable by the banks on demand:
- 1. Such deposits are generally maintained by businessmen with the intention of making transactions with such deposits.
- 2.They can be drawn upon by a cheque without any restriction.
- 3. Banks do not pay any interest on these accounts. Rather, banks impose service charges for running these accounts.

(ii) Fixed Deposits or Time Deposits

- Fixed deposits refer to those deposits, in which the amount is deposited with the bank for a fixed period of time.
- 1. Such deposits do not enjoy cheque-able facility.
- 2.These deposits carry a high rate of interest.

(iii) Saving Deposits:

- These deposits combine features of both current account deposits and fixed deposits:
- 1.The depositors are given cheque facility to withdraw money from their account. But, some restrictions are imposed on number and amount of withdrawals, in order to discourage frequent use of saving deposits.

2. Advancing of Loans

- The deposits received by banks are not allowed to remain idle. So, after keeping certain cash reserves, the balance is given to needy borrowers and interest is charged from them, which is the main source of income for these banks.

(i) Cash Credit

- 1.Cash credit refers to a loan given to the borrower against his current assets like shares, stocks, bonds, etc. A credit limit is sanctioned and the amount is credited in his account.The borrower may withdraw any amount within his credit limit and interest is charged on the amount actually withdrawn

(ii) Demand Loans:

- Demand loans refer to those loans which can be recalled on demand by the bank at any time.The entire sum of demand loan is credited to the account and interest is payable on the entire sum.

(iii) Short-term Loans

- _They are given as personal loans against some collateral security.The money is credited to the account of borrower and the borrower can withdraw money from his account and interest is payable on the entire sum of loan granted.

3. Creation of credit

- Credit creation is most significant function of commercial banks. While sanctioning a loan to a customer, they do not provide cash to the borrower. Instead, they open a deposit account from which the borrower can withdraw. In other words, while sanctioning a loan, they automatically create deposits, known as a credit creation from commercial banks.

4. Clearing of cheques.

It is the process of moving a cheque from the bank in which it was deposited to the bank on which it was drawn, and the movement of the money in the opposite direction. This process is called the clearing cycle and normally results in a credit to the account at the bank of deposit, and an equivalent debit to the account at the bank on which it was drawn

SECONDARY FUNCTIONS

- 1. Agency Services.
- 2. General Utility Services.

1. Agency Services:

- Banks act as agents to their customers in different ways:
- (i)Collection and Payment ofVarious Items: Banks collect cheques, rent, interest etc. on behalf of their customers and also make payment of taxes, insurance premia etc. on their behalf.

- (ii) Purchase and Sale of Securities: Banks normally are more knowledgeable with regard to stock and share business. As such they buy, sell and keep in safe custody the securities on behalf of their customers.
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- (iii) Trustee and Executor: Banks also act as trustees and executors of the property of their customers on their advice.
- (iv) Remitting of Money: Banks also remit money from one place to the other through bank drafts.

2. General Utility Services:

- Commercial banks also provide certain services of general utility to the society: (i)Locker Facilities:
- Banks provide locker facilities to their customers. People can keep their gold or silver jewellery or other important documents in these lockers. Their annual rent is very nominal.

- (ii) Traveller's Cheque and Letters of Credit:
- Banks issue traveller's cheque and letters of credit to their customers so that they may be spared from the risk of carrying cash during their journey. (iii) Business Information and Statistics: Being familiar with the economic situation of the country, the banks give advice to their customers on financial matters on the basis of business information and statistical data collected by them.