Question Paper
Money and Banking and Credit Management (MB3G1B) : January 2009

Section A : Basic Concepts (30 Marks)

- This section consists of questions with serial number 1 - 30.
- Answer all questions.
- Each question carries one mark.
- Maximum time for answering Section A is 30 Minutes.

<Answer>

1. Which of the following is **not** considered as an attribute of money?

(a) Durability
(b) Uniformity
(c) Divisibility
(d) Acceptability
(e) Stability in value.

<Answer>

2. Control of inflation has been regarded as the principal economic policy in all countries of the world. Which of the following method(s) is adopted to control inflation?

I. Fiscal Policy.
II. Economic Policy.
III. Monetary Policy.
IV. Direct wage Controls.

(a) Only (I) above
(b) Both (I) and (II) above
(c) Both (II) and (III) above
(d) (I), (III) and (IV) above
(e) All (I), (II), (III) and (IV) above.

<Answer>

3. Which of the following is **not** treated as an advantage of 'Intermediation'?

(a) Liquidity
(b) Risk pooling
(c) Familiarity
(d) Information
(e) Risk reduction.

<Answer>

4. The liquidity management and interest rates of 'Local Area Banks' (LABs) is governed by which of the following Acts?

(a) Banking Regulation Act
(b) Reserve Bank of India Act
(c) Regional Rural Banks Act
(d) Negotiable Instruments Act
(e) National Bank for Agriculture & Rural Development (NABARD) Act.

<Answer>

5. When the guarantor extinguishes the liability of a debtor, he (the guarantor) acquires all the rights of the creditor. This right is known as the right of

(a) Subrogation
(b) Appropriation
(c) Lien
(d) Set-off
(e) Assignment.

<Answer>

6. Product Price Index measures

(a) The price of a selected basket of goods
(b) The price received by a producer
(c) The changes in price of a selected basket of goods
(d) The change in price of a selection of commodities
(e) The rise in price accompanied by increase in production.

<Answer>

7. Creeping inflation means

(a) Monthly increase in prices is more than 20 per cent
(b) The sustained rise in prices is about 10 per cent per annum
(c) Sustained rise in prices of annual increase of less than 3 per cent per annum
(d) The rise in prices is in the intermediate range of more than 3 to 6 per cent per annum
(e) The sustained rise in prices of annual increase of more than 5 per cent per annum.

<Answer>

8. Real rate of interest is

(a) The interest earned by an asset
(b) The rate which is expressed in terms of percentage
(c) The pure interest for the use of money or for the loan of money capital
(d) The payment made to cover risks or loss, payments for work etc
(e) The payment made to lender after reducing the discount allowed on a loan.

<Answer>

9. When financial intermediaries collect savings from individuals/others and pool them to give loans to others is known as

(a) Default-risk intermediation
(b) Financial disintermediation
(c) Maturity intermediation
(d) Denomination intermediation
(e) Liquidity intermediation.

<Answer>

10. Which of the following is **not** considered as a Non-Banking Finance Company?

(a) Credit Rating agencies
(b) Merchant Banking companies
(c) Portfolio Management companies
(d) Loan and Investment companies
(e) Leasing and Hire-purchase companies.

<Answer>

11. Which of the following is/are the various model(s) of Government regulation of Banks?

I. Lender of Last Resort.
II. Rehabilitation.
III. Bank Bailouts.
IV. The Paternalistic Approach.
V. Market-Assisted Models.

(a) Only (I) above
(b) Both (I) and (II) above
(c) Both (II) and (III) above
(d) (I), (III) and (IV) above
(e) All (I), (II), (III), (IV) and (V) above.

<Answer>

12. Which of the following is classified/grouped under the head ‘other income’ in a bank’s Profit and Loss Account? Income received

(a) On investments
(b) On loans and advances
(c) On balances with RBI
(d) By way of commission, exchange and brokerage
(e) By way of discount and Interest on bills.

13. Which of the following is **not** coming under the category of 'Other Subsidiary Registers' maintained by a bank? <Answer>

(a) Jewellery Register
(b) Standing Order Register
(c) Overdraft Sanction Register
(d) Demand Draft Register
(e) Letter of Guarantee Register.

14. A charge by a bank **cannot** be created on moveable assets by way of <Answer>

(a) Banker's lien
(b) Assignment
(c) Hypothecation
(d) Appropriation
(e) Pledge.

15. For the purpose of fixation of drawing power, stocks of imported raw material is valued at <Answer>

(a) Invoice price plus demurrages, if any
(b) Invoice price plus customs duty and Sales tax
(c) Invoice price or market price whichever is higher
(d) Landed Cost excluding Sales tax and demurrage or market price whichever is lower
(e) Landed Cost including Sales tax or market price whichever is lower.

16. The rate at which over night money is borrowed in the market is known as <Answer>

(a) Bank rate
(b) Swap rate
(c) Exchange rate
(d) Discount rate
(e) Call money rate.

17. Under loan evaluation procedure, which of the following is **not** an essential part of credit risk analysis? <Answer>

(a) Ability to raise funds
(b) Cost of capital
(c) Regulatory environment
(d) Coverage ratios
(e) Interest rate risk management.

18. If the simple deposit multiplier is equal to 5, then the required reserve ratio is equal to <Answer>

(a) 0.15
(b) 0.20
(c) 0.25
(d) 0.40
(e) 0.50.

19. Which type of letter of credit provides for advance payment before the actual presentation of documents? <Answer>

(a) Red Clause Letter of Credit
(b) Revolving Letter of Credit
(c) Irrevocable Letter of Credit
(d) Green clause letter of Credit
(e) Back-to-Back Letter of Credit.

20. To qualify under Tier II capital, the subordinated debt instruments should have a minimum maturity of <Answer>

(a) Two years
(b) Three years
(c) Five years
(d) Seven years
(e) Ten years.

21. The credit facility in which the physical possession of the security is passed on to the lending banker but retains the ownership with the borrower. <Answer>

(a) Open Cash Credit (Hypothecation)
(b) Term loan Hypothecation
(c) Key Cash Credit (Pledge)
(d) Overdraft (Secured)
(e) Clean Loan.

22. Within how many days from the date of such payment or satisfaction, the report of satisfaction is to be filed with Central Registrar by a Securitization or Reconstruction Company or Secured Creditor as the case may be <Answer>

(a) 14 days from the date of payment or satisfaction
(b) 15 days from the date of satisfaction of the claim amount
(c) 30 days from the date of payment or satisfaction
(d) 60 days from the date of satisfaction of the claim amount
(e) 90 days from the date of satisfaction of the claim amount.

23. A Self- Help Group (SHG) is identified by which of the following features? <Answer>

I. It is a registered or unregistered group of micro entrepreneurs.
II. Its members are homogenous with social and economic background.
III. They come together voluntarily, to save small amounts and contribute to a common fund regularly.
IV. The group members ensure proper end-use of credit and timely repayment.

(a) Both (I) and (II) above
(b) Both (II) and (III) above
(c) (I), (II) and (III) above
(d) (I), (II) and (IV) above
(e) All (I), (II), (III) and (IV) above.

24. Which of the following liabilities is classified under demand liabilities for the computation of Net Demand and Time Liabilities (NDTL)? <Answer>

(a) Staff security deposits
(b) Unclaimed deposits
(c) Cumulative deposits
(d) India Development Bonds
(e) Deposits held as security for advances.

25. Security documents are **not** generally attested or witnessed. What is the effect of attesting/ witnessing of a document? <Answer>

(a) The nature of the contract does not change
(b) Attracts no stamp duty at all
(c) Attracts nominal stamp duty
(d) Attracts ad valorem stamp duty
(e) Attracts registration of documents.

26. Section 34 of the RDBFI Act excludes a similar act from the exercise of the ‘non-obstante clause’ contained in its provisions. Identify. <Answer>

(a) Reserve Bank of India Act
(b) The Transfer of Properties Act
(c) The Companies Act
(d) The Contract Act
(e) The Negotiable Instruments Act.

27. A bank’s Capital Adequacy Ratio (CAR) is at 11 percent, Average Risk Weight (ARW) is 60 percent and Capital is Rs.180 crores. What are the total assets of the Bank? <Answer>

(a) Rs.3,142 crores
(b) Rs.2,964 crores
(c) Rs.2,727 crores
(d) Rs.2,594 crores
(e) Rs.2,491 crores.

28. As regards the features of a company vis-à-vis a partnership firm, which of the following statements is **false**? <Answer>

(a) Death or insolvency of a partner dissolves the firm unless otherwise provided for
(b) The minimum number of partners in a firm is 2 and maximum is 20 in the case of banking business and 10 in the case of other businesses of a partnership firm
(c) The liability of a shareholder is limited to the extent of his share/guarantee in a company
(d) The creditors of a company can proceed only against the company and not against its members
(e) A partner cannot contract with his firm whereas a member of a company may.

29. Which of the following statements is **false** with regard to pre-shipment finance? Pre-shipment advance <Answer>

(a) Period normally exceeds 191 days
(b) Covers the working capital needs of the exporter
(c) Is based on the existence of export order and/or letters of credit
(d) Is for purchase of raw materials, processing, packing, transportation and for warehousing of goods
(e) Liability is to be liquidated by submitting export documents within the stipulated period.

30. While computing the Net Demand and Time Liabilities (NDTL) which of the following liabilities is **not** to be included? <Answer>

(a) Borrowings from Exim Bank, IDBI etc.
(b) Staff security deposits
(c) Gold borrowed by banks from abroad
(d) India Development Bonds
(e) Net credit balance in the inter-branch adjustment account.

END OF SECTION A

Section B : Problems/Caselets (50 Marks)

- This section consists of questions with serial number 1 – 9.
- Answer all questions.
- Marks are indicated against each question.
- Detailed workings/explanations should form part of your answer.
- Do not spend more than 110 - 120 minutes on Section B.

1. Consider the following particulars of Nagarjuna Bank Limited as on 31.03.2008. <Answer>

Asset particulars	Amount (Rs. in lakhs)
Standard	2900
Sub-standard assets	1080
Doubtful assets (secured)	
Upto 1 year	420
Upto 1- 3 years	210
More than 3 years	180
Loss assets	90

The proportion of security available for the doubtful assets is 65%, 40% and 25% for the three categories respectively.

You are **required** to assess the amount of provisioning the bank has to make as on **(6 marks)**

2. You are **required** to complete the following table: <Answer>

Real Interest Rate (%)	Nominal Interest Rate (%)	Inflation Rate (%)
2	?	5
0	8	?
?	7	9
?	4	5
–2	12	?
–2	?	5

(3 marks)

3. The following table shows the capital, asset and profit position of three banks as on March 31st, 2008. <Answer>

(Rs. in crores)

Bank	Capital	Asset	Risk Weights	PAT
A	360	7000	50%	120
		2000	100%	
B	500	8000	50%	200
		2000	100%	
C	1200	20000	50%	300
		3000	100%	
		8000	20%	

You are **required** to calculate:

a. The Capital Adequacy Ratio of each bank **(4 marks)**

b. Which bank (by using ENPA) do you consider as being exposed to greater credit risk?

(Assume the tax rate at 30% and proportion of NPAs in total assets as 15% for all banks) **(5 marks)**

4. The following is the extract of cash credit account of Victory Traders in the books of Super Bank Ltd. <Answer>

Date	Balance (Rs.)
01/07/2008	2,00,000
25/07/2008	2,20,000
01/08/2008	2,40,000
25/08/2008	2,60,000
01/09/2008	2,80,000
10/09/2008	3,00,000
25/09/2008	2,48,000

Cash Credit Limit Rs.3,00,000
Rate of interest 12% p.a.

Assuming that the number of days in a year is 360 days.

C**alculate** the amount of interest charged by the bank on the cash credit account of the company for the quarter ended September 30, 2008. **(4 marks)**

Caselet 1

Read the caselet carefully and answer the following questions:

5. What is monetary policy? Discuss the prime objectives of monetary policy. **(6 marks)** <Answer>

6. RBI uses various tools to implement its monetary policy. Discuss about these tools in brief. **(7 marks)** <Answer>

The state of flux characterizing global macroeconomic and financial conditions has confronted the conduct of monetary policy in various parts of the world with a similar spectrum of uncertainties and shifts therein. In fact, policy decision making in all countries has had to contend with difficulties of distinguishing news from noise in monitoring variables that are used to gauge the state of economic activity and the evolution of financial markets. This has made the dilemmas facing monetary policy sharper and policy errors costlier than before. In turn, this has brought about considerable cross-fertilization and convergence in policy settings, choice of instruments and communication strategies. For monetary authorities vested with multiple objectives, the challenge is to continually rebalance the weights assigned to each. Superimposed upon issues are country-specific factors which warrant tailored policy responses. For India, the linkages with the rest of the world in the context of the growing integration with the global economy are getting stronger and accordingly, global developments are becoming increasingly significant. Nevertheless, the evolution of domestic conditions of high growth with price stability, stable and vibrant financial markets and institutions, comfortable foreign exchange reserves and the entrenchment of democratic processes provide room for flexible and timely responses to the evolving circumstances in an uncertain external environment.

The Annual Statement on Monetary Policy on the basis of a broadly unchanged assessment of the macroeconomic outlook noted that increased global uncertainties, high and volatile international prices of oil, incomplete pass-through of oil prices domestically, changes in trajectory of the policy rate in the US, overhang of liquidity, credit growth, sustained industrial growth and possible capacity pressures, enlargement of the trade deficit, infrastructural constraints and delayed monsoon could prompt a change in the stance of policy.

In the overall assessment of the RBI Governor, there have been significant shifts in both global and domestic developments in relation to initial assessments. The dangers of global recession have increased at the current juncture although consensus expectations do not rule out a soft landing. On the domestic front, the outlook remained positive up to January 2008. Since then, the prospects for growth in the year ahead have been trimmed as risk to inflation and inflation expectations from the upside pressures due to international food, crude and metal prices have become more potent and real than before.

For monetary policy purposes, real Gross Domestic Product (GDP) growth in 2008-09 may be placed in the range of 8.0 to 8.5 per cent, assuming that (a) global financial and commodity markets and real economy will be broadly aligned with the central scenario as currently assessed and (b) domestically, normal monsoon conditions prevail.

In view of the lagged and cumulative effects of monetary policy on aggregate demand and assuming that supply management would be conducive, the policy endeavour would be to bring down inflation from the current high level of 12 per cent in 2008-09 to as low as soon as possible.

The RBI Governor observed that for barring the emergence of any adverse and unexpected developments in various sectors of the economy, assuming that capital flows are effectively managed and keeping in view the current assessment of the economy including the outlook for growth and inflation, the overall stance of monetary policy in 2008-09 broadly be focussed:

- To ensure a good monetary and interest rate environment that accords high priority to for growth in financial markets while being conducive to continuation of the growth momentum.
- To respond swiftly on a continuing basis to the evolving constellation of adverse international developments and to the domestic situation
- To emphasize credit quality as well as credit delivery, in particular for employment-intensive sectors, while pursuing financial inclusion.

END OF CASELET 1

Caselet 2

Read the caselet carefully and answer the following questions:

7. Define interest and explain its relationship with the inflation. **(5 marks** <Answer>
8. Explain the functions of interest rates. **(6 marks)** <Answer>
9. Explain the relationship between short-term and long-term interest rates. **(4 marks)** <Answer>

The central bank of Namibia has hiked interest rates yet again, this time by 50 basis points. It stated continued inflationary pressures as the reason for hiking the rates. How does hiking interest rates help arrest inflation?

When the central bank hikes interest rates, commercial banks follow suit. These banks, for instance, will raise the lending rates to companies.

Companies gradually build this higher borrowing cost into their product prices. Consumers, thus, end up paying higher prices for the goods and services purchased.

The higher prices are expected to force consumers to cut their purchases. Lower purchases means lower demand for goods and services.

This in turn, means a reduction in the excess demand over supply. And this reduction is expected to bring down inflation. How? It is the imbalance in demand and supply of goods that creates inflationary pressures in the first place.

To explain, take onions. Suppose one kg costs Rs.10 when the total supply in a given market is 100 kg and the demand is 90 kg. What if the demand increases to, say, 130 kg? Given the fact, that supply is just limited to only 100 kg, not all consumers can satisfy their demand for onions. This may prompt some consumers to pay more than Rs.10 for one kg of onions. And that may trigger the onion vendors to ask a higher price per kg.

Now, extend this argument to the entire economy. When demand for all goods and services are higher than the supply, consumers may be willing to pay a higher price. This consumer behavior results in an overall increase in general prices or higher inflation.

By hiking interest rates, the central bank is actually trying to reduce the excess demand for goods and services. If the central bank succeeds in reducing the demand, consumers' willingness to pay a higher price is also reduced. Inflation is, thus, expected to be arrested. Central banks are normally very careful when using interest rates as a tool for taming inflation. If used excessively, hiking interest rates can actually choke economic growth.

END OF CASELET 2

END OF SECTION B

Section C : Applied Theory (20 Marks)

- This section consists of questions with serial number 10 - 12.
- Answer all questions.
- Marks are indicated against each question.
- Do not spend more than 25 - 30 minutes on Section C.

10. Execution of a document is an important process of documentation. Explain. **(6 marks)** <Answer>

11. Banks are the custodians of the general public's money, which they accept in the form of deposits and pay out on the client's instructions. What are the various functions performed by banks in general? **(6 marks)** <Answer>

12. The Debt Recovery Tribunal (DRT) has been given certain powers to recover the dues from the defaulters. Explain the functions of DRT. **(8 marks)** <Answer>

END OF SECTION C

END OF QUESTION PAPER

Suggested Answers
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Section A : Basic Concepts

	Answer	Reason	
1.	E	The stability of value of money is not constant and is always fluctuating and as such people do not hold money because of its stability is a false statement. All other options are correct and attributes of money.	< TOP >
2.	D	There are three important ways to control inflation. They are • Monetary policy • Fiscal policy and • Direct wage control Economic policy is not one of the tools to control inflation. It is only a policy draft of the government.	< TOP >
3.	B	The advantages of 'Intermediation' lie in the following: Liquidity: It provides the vital link between the entity which needs funds and the entity which has funds. Cost of Funds: Overall cost of funds to the borrower gets reduced. Information: It provides vital data to the Corporates about the extent of funds availability and the details of cost of funds which enable the companies to draw their plans. Risk Reduction: The lenders of funds need not be concerned with the risk profile of the borrowers since the intermediary takes care of the risk associated with lending to Corporates. Familiarity: The Financial Intermediaries know the intricacies of law, the procedure to be adopted, the manner in which the documents need to be obtained etc better than individual corporates Risk pooling is not an advantage related to 'Intermediation'.	< TOP >
4.	C	With regard to liquidity requirements and interest rates, the Local Area Banks (LABs) would be governed by the provisions applicable to Regional Rural Banks established under the Regional Rural Banks Act, 1976.	< TOP >
5.	A	When the guarantor discharges all the liability of the debtor, the guarantor is entitled to all the rights of the creditor and steps into the shoes for all purposes. This right is known as 'right of Subrogation'. The other rights are acquired by a bank when he grants an advance or something is pledged for safe custody in the normal course of business. .	< TOP >
6.	B	Product Price Indexes (PPIs) measure the price received by a producer. (a) Measures the Consumer Price Index (c) Measures the Whole Sale Price index (d) Measures the Commodity Price Indexes (e) One of the two kinds of price rise as per Keynesian theory of inflation.	< TOP >
7.	C	Creeping inflation means a sustained rise in prices of annual increases of less than 3 percent per annum. Option (a), (b) and (d) relate to Walking inflation, Running inflation and Galloping inflation respectively. Option (e) is an incorrect statement.	< TOP >
8.	A	Real interest is the rate of interest earned by an asset. The remaining options relate to other types of interest such as net interest, gross interest or money rate etc.	< TOP >
9.	D	Denomination intermediation is a kind that occurs when small amount of savings from the individuals and others are collected and pooled so as to give loans to others.	< TOP >

10. A Credit rating agencies or Nidhis with capital of less than Rs.25lacs or members with less than 2000 is not considered as a NBFC. All others are correct. < TOP >

11. E All the models are of Government regulation which oversee the functioning of banks and provide necessary relief and guidance in managing and averting a crisis. < TOP >

12. D Commission, Exchange and Brokerage received includes remuneration on services (other income) such as commission on collection, letters of credit and guarantees, government business and other permitted agency business besides consultancy and other services. < TOP >

13. C Overdraft sanction register comes under the category of 'Other Memoranda Books' and the rest of the books relate to 'Other Subsidiary Registers' < TOP >

14. D The statement of appropriation is the right conferred on the banker to appropriate the payments received from a debtor towards discharge of some debt, as per Indian Contract Act vide Sections 59 to 61. All other options stated in the question enable a banker to create a charge on the moveable assets of a debtor. < TOP >

15. D Stocks of imported raw material is valued at 'landed cost exclusive of sales tax and demurrage charges if any or market price whichever is lower, for the purpose of fixation of drawing power < TOP >

16. E Call money market is a market for very short-term funds, which is also known as money at call and short notice. The rate at which funds are borrowed and lent is called call money rate. < TOP >

17. C Repayment of the loan by the clients depends greatly on their financial soundness. Hence, < TOP >

financial analysis becomes an imperative part of credit risk analysis and they include the following:

Financial leverage, Coverage ratios, Cost of Capital, Ability to raise funds, Working capital management and Interest rate risk management. Regulatory environment is seen while studying the Industry level prospects.

18. B The deposit multiplier establishes the relationship between the cash reserves and deposits. < TOP >

K = l / r where k is deposit multiplier and r is the cash reserve ratio.

If the deposit multiplier is 5, then 'r' would be equal to 1 / 0.50 which is 0.20. Therefore

(b) is the correct answer.

19. A A letter of credit that provides for payments before the presentation of documents for shipment < TOP >

of the goods is a Red Clause Letter of Credit.

In Green clause letter of credit provides payment upto the point of loading of goods along side the ocean carrier .and in Back- to-Back letter of credit, a letter of credit is opened with another letter of credit as a security.

20. C The subordinated debt instruments to have a minimum maturity of 5 years and if the instruments are issued in the last quarter of the year i.e., between January to March, the period of debt should have a tenure of 63 months. < TOP >

21. C When security is pledged to the bank for the purpose of securing a loan, then such type of credit is called Key Cash Credit (Cash Credit Pledge). The possession of the goods will be with the bank where as in Open Cash Credit (Hypothecation), the possession will be with the borrower. < TOP >

22. C The Securitization Company or the Reconstruction Company or the secured creditor requiring registration should give intimation to the Central Registry about the payment or satisfaction in full within 30 days from the date of receipt of payment or satisfaction. < TOP >

23. E Some of the features of SHG are: It is a registered or unregistered group of micro entrepreneurs, its' members have homogenous social and economic background, who come together voluntarily, save small amounts and contribute to a common fund regularly and group members ensure proper end-use of credit and timely repayment.. < TOP >

24. B Unclaimed deposits is a demand liability and all the other liabilities are examples of time liabilities. < TOP >

25. D Normally bank documents do not require attestation or witnessing unless specifically mentioned or needed. If the documents are attested or witnessed, the very nature of document/s change attracting payment of ad valorem stamp duty which will cost the borrower heavily and is not economical. < TOP >

26. C The Companies Act of 1956 is also a special act like that of RDBFI Act of 1993. Section 446 of the Companies Act 1956 which contains non-obstante clause also has a provision to exclude all other laws with regard to pending suits in which Company in liquidation is a party. RDBFI is also a special law and notwithstanding the special provisions contained in the Companies Act, 1956, Section 34 of the RDBFI Act is brought into effect and thus the exercise of powers under Section 446 of Companies Act is excluded. All other Acts stated have no such special powers. < TOP >

27. C Total assets is computed as under: < TOP >

Total assets	=	Capital (divided by) CAR × Average risk Weight
Capital Adequacy Ratio	=	11%
Capital	=	Rs.180 crs
Hence risk weighted assets	=	180 × 100 / 11 = Rs. 1,636 crs
Risk Weightage	=	60%
Total assets = 1636 × 100 / 60	=	Rs. 2,727 crs

28. B The minimum number of partners in a firm is 2 and maximum is 10 in the case of banking business and 20 in the case of other businesses. Rest of the statements are all correct. < TOP >

29. A Pre-shipment advance (packing credit) depends upon the manufacturing trade cycle or the specific requirements of the individual exporter. However, the period does not normally exceed 180 days. Rest of the options are all true. < TOP >

30. A Borrowings from Exim bank, IDBI, RBI, NABARD, NHB, IRBI and SIDBI are not to be included in the computation of NDTL Staff Option (b) relates to security deposits and Option (d) relates to India Development bonds which are included as Time liabilities and options (c) and (e) are forming part of other liabilities. < TOP >

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Section B : Problems

1. The following is the detailed schedule of provisioning of Nagarjuna Bank limited for the year ended 31.03.2008 < TOP >

Amount in Rs. in lakhs

Nature of Asset	Amount in Rs.	Provision %		Amount of provision in Rs.
Standard assets	2900	0.25%		7.25
Sub-standard assets	1080	10.00%		108.00
Doubtful assets				
Upto 1 year	420	20.00%	0.35 × 420 = 147 0.65 × 420 = 273 × 0.20 = 54.6	147.00 54.60
1 to 3 years	210	30.00%	0.60 × 210 = 126 0.40 × 210 = 84 × 0.30 = 25.2	126.00. 25.20
Above 3 years	180	50.00%	0.75 × 180 = 135 0.25 × 180 = 45 × 0.5 = 22.5	135.00 22.50
Loss assets	90	100.00%		90.00
Total amount of provision				Rs.715.55 lakhs

2.The real interest rate = Nominal Interest rate – Inflation rate < TOP >

Real Interest Rate (%)	Nominal Interest Rate (%)	Inflation Rate (%)
2	7	5
0	8	8
-2	7	9
-1	4	5
-2	12	14
-2	3	5

3.Capital Adequacy Ratio (CAR) < TOP >

$$A : \frac{360}{7,000 \times 0.5 + 2,000} = 6.55\%$$

$$B : \frac{500}{8,000 \times 0.5 + 2,000} = 8.33\%$$

$$C : \frac{1,200}{20,000 \times 0.5 + 8,000 \times 0.2 + 3,000} = 8.22\%$$

EWPA of A	$\frac{PAT/(1-T)TA}{NPA/TA} = \frac{120/0.7 \times 9,000}{0.15}$	= 12.70
B	$\frac{200/0.7 \times 10,000}{0.15}$	= 19.05
C	$\frac{300/0.7 \times 31,000}{0.15}$	= 9.22%

The higher the ENPA the greater the margin of safety.

The ENPA is the percentage of NPAs of the bank which if turned into low assets the current year's profit will be wiped out. ENPA is highest for B and indicates that Bank B has lowest credit risk.

Since higher profits help in managing the credit risk, Bank B with a higher percentage of ENPA is in a better position.

Considering the ratios together it can be said that Bank B with a higher percentage of ENPA is in a better position.

Considering the ratios together it can be said that Bank 'B' is in a better position to withstand the credit risk.

Of the three banks Bank 'C' is exposed to greater credit risk followed by Bank 'A'.

4. < TOP >

Date	Balance	Days	Products
01/07/2008	2,00,000	24	48,00,000
25/07/2008	2,20,000	7	15,40,000
01/08/2008	2,40,000	24	57,60,000
25/08/2008	2,60,000	7	18,20,000
01/09/2008	2,80,000	9	25,20,000
10/09/2008	3,00,000	15	45,00,000
25/09/2008	2,80,000	6	16,80,000
Total		92	2,26,20,000

Interest due for the quarter = $\frac{2,26,20,000 \times 12}{360 \times 100} = \text{Rs.}7,540$

5.Monetary policy announced by the central bank is the deliberate control of the creation of money to achieve economic goals. The prime objective of monetary policy are – price stability and economic growth. < TOP >

Volatility/rise in prices result in uncertainty in decision-making. When this uncertainty relates to a rise in price or inflation, as it is known, it may have an adverse impact on the savings thereby leading to a liquidity crisis. On the contrary, if the price instability relates to downward movement or deflation, then investments will become riskier resulting in excess money supply. When there is liquidity crisis due to inflation, the effect may eventually be felt on the interest rates, which tend to rise. When price stability becomes the objective of the monetary policy, the money supply should be adjusted to such a level that there is a trade-off between monetary expansion and contraction. While these measures may ensure a stable interest rate structure, steps may also be taken to prevent abnormal rise or fall in these rates.

Various factors influence the economic growth of nation. Chief among them are money supply, interest rates and exchange rates. Monetary expansion stimulates economic activity thereby leading to economic growth. However, sometimes-rapid expansion may become the cause for a rise in the inflation. This possibility of a rise in inflation may restrain economic expansion leading to a slow down in the economic growth. A fall out of the unevenness in the money supply will be the fluctuations in the interest rates, and if this fluctuation is inclined upwards i.e. increasing interest rates, it may restrict economic growth. Similarly, consider the exchange rate fluctuations – the other factor that may influence economic growth rate. Rise in money supply may depreciate the domestic currency. Measures taken to prevent this depreciation may adversely affect the economic growth. It can be observed that excess focus on one objective may have an adverse impact on the other. Whatever may be the objective of the monetary policy, it should be ensured that the measures taken to attain one objective should not have an adverse impact on the other.

6.Monetary policy followed by RBI aims to accelerate economic development in an environment of reasonable price stability and to develop appropriate institutional set up to aid this process. To achieve this, the Central Bank follows a number of monetary tools to manage the liquidity in the system, which are given here under: < TOP >

- Open Market Operations (OMOs)
  - Cash Reserve Ratio (CRR)
  - Statutory Reserve Ratio (SLR)
  - Bank Rate
  - Selective Credit Control

RBI manages the money supply in the economy through OMOs by sales and purchases of Government securities. These might be purchase and sale of treasury bills or implement repos and reverse repos. When the market is flooded with money, the RBI might suck the excess money by selling treasury bills or introducing repos. Similarly, when the economy suffers from dearth of money, RBI infuses money by way of buying treasury bills and introducing reverse repos.

Apart from OMOs, RBI regulates money supply by using tools such as CRR, bank rate and SLR. CRR determines the amount of cash that banks are required to maintain with the RBI. SLR determines the liquid funds banks are required to maintain with the Central Bank either in the form of cash or highly liquid assets like Government securities etc. Bank rate is the rate at which the RBI refinances the banks.

While OMOs are used to manage the transitory liquidity in the system, the other regulating tools are used to steer the long-term trend of money supply in the economy. When CRR is hiked, money flows from the system to the RBI, thus arresting money supply within the system. Similar is the effect of SLR changes. The bank rate sends a signal of interest rate level to the economy. When the bank rate is lowered, it means that banks can borrow from the Central Bank at a lower rate, thus enabling them to lend at a lower rate and vice versa.

7.Interest is the payment made and received for the use of a loan. Interest is the reward for parting with liquidity. < TOP >

Inflation is a major factor determining the level of interest rates. The longer the duration of the loan, the greater the risk that inflation can accelerate, reducing the purchasing power of the loan repayment. So, rates, generally are higher on long-term loans than on short-term loans, because people who lend for longer periods have to be compensated for the risk that inflation might accelerate during the longer periods.

Usually, long-term interest rates are higher than short-term interest rates. This is called a "normal yield curve" and reflect the higher "inflation-risk premium" that investors demand for longer term bonds. When interest rates change by the same amount for bonds of all terms, this is called a "parallel shift" in the yield curve since the shape of the yield curve stays the same, although interest rates are higher or lower "across the curve'1. A change in the shape of the yield curve is called a "twist" and means that interest rates for bonds of some terms change differently than bond of other terms.

8.Functions of Interest Rates < TOP >

The interest rate (i.e., the price of credit) is the price a borrower must pay to secure loanable funds from a lender. The functions of the interest rate are to:

- Influence the savings flow in an economy. Given the level of income, the higher the rate of interest, the more will be the volume of savings.
- The rate of interest determines the volume of investment in an economy. If the rate of interest is decreased, the businessmen borrow more thereby expanding their investment promoting economic growth.
- The rate of interest equilibrates the supply of and demand for money, which stabilizes the level of economic activity.
- It rations the available supply of credit generally providing loanable funds to those investment projects with the highest expected returns.
- It is an important tool of government policy through which it influences on the volume of savings and investment.

These fundamental interest rate roles include (a) generating an adequate volume of savings in order to fund investment and growth in the economy; (b) directing the flow of credit in the economy towards those investment projects carrying the highest expected rates of return; (c) bringing the supply of money (cash balances) into alignment with the demand for money so that the money market will achieve a stable equilibrium; and (d) serving as a tool of government economic policy so that the nation can better achieve its broad economic goals of full employment, avoidance of serious inflation, sustainable economic growth, and a stable equilibrium in the nation's balance of payments with the rest of the world in a better way.

9.There is a strong relationship between the short-term and long-term interest rates. The movement in the short-term rates of interest will be followed by a movement in the same direction in the long-term interest rate also. If the RBI raises its bank rate, consequently the commercial banks raise their interest rates on all loans and advances as well as on their deposits. Firms and individuals keep their liquid assets in the form of time deposits or in long-term instruments while their liabilities can be either long-term or short-term. When the short-term rates of interest of commercial banks rise, the firms may not loan from banks at higher rates but instead raise the same from the market through debentures. This large sale of long-term securities by the firms will reduce the prices of securities and raising their yield rates. Thus a rise in the short-term rates leads to a rise in the long-term interest rates. Exactly the opposite happens when the central bank decreases the bank rate. < TOP >

When the monetary authorities attempt to influence the short-term interest rates, they would also influence the long-term interest rates in the same direction. In the long run, the public opinion and market expectations also play an important role.

Section C: Applied Theory

10. A major activity in the execution of a document is the actual signing of the documents by the executants at the appropriate places in the prescribed documents. The documents need to be < TOP >

executed at the bank in the presence of the Manager or an authorized officer. The signature/s of the borrower/s should be obtained in full and there should not be any variation in signatures in the entire set of documents. A special note has to be put up, if the borrower is a left-hander. Any alterations made by the borrower in the document are to be duly authenticated by his/her signature in full to avoid any problems in future. The borrower has to affix his signature on the document on all the pages and on the fold of the pages that face each other, and on the last page of the loan agreement forms, and on the schedule of securities. All the executants must be legally competent to execute the documents.

Attestation: Unless specially mentioned and unless there is a specific requirement, the documents should not be attested or signed by the witnesses as it will have the effect of changing the very nature of the contract attracting ad valorem stamp duty.

The other important steps to be taken care of are:

- Documents must be in accordance with the letter of arrangement, and the resolution.
- Check whether proper stamp duty is paid using adhesive/non-adhesive stamps.
- Check for the resolution regarding the opening and operation of the bank account and also whether the required resolutions are passed in the Articles of Association.
- In case of joint stock companies, it has to be checked whether the charge that is created is registered with the Registrar of Companies. The modifications of charge are to be registered with the Registrar of Companies and the common seal is to be affixed.
- DP and the DP delivery note is to be signed and endorsed by the borrower and the guarantor and revival letter has to be signed by the borrower and guarantor regularly.

The Demand Promissory Note (DPN) has to be affixed with revenue stamps and cancelled. The documents have to be registered and if needed renewed.

11. Basic Functions of Banking

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Banks exist for one of two generic reasons: (i) they are able to perform services that cannot be provided by other means or types of firms; and/or (ii) they have a comparative advantage in the provision of these services. The basic functions performed by the banks are:

i. Money creators: Banks create money by way of deposit liabilities. In contrast to the liabilities of other institutions, bank liabilities (cheques) are generally accepted as a means of payment.

ii. Effective payments system: Banks provide a sound and stable mechanism to effect payments. This task not only involves the payment of cheques, but also of credit and debit cards, ATMs, etc.

iii. Creators of indirect financial securities: Banks operate as financial intermediaries placing themselves between ultimate lenders and borrowers; and transforming primary securities (i.e., liabilities of firms) into indirect securities (i.e., liabilities of financial intermediaries that are desired by investors). Accordingly, banks hold assets that are subject to specific risks, while issuing claims against them in which these risks are largely eliminated through diversification. In essence, banks are similar to other financial intermediaries in performing this function, but have a competitive advantage because they enjoy economies of scale and scope and have better information.

iv. Information agents: Owing to an asymmetric supply of information (i.e., information not available to all) borrowers choose, often for competitive reasons, not to make relevant information publicly available (i.e., in the capital market), but are willing to share it with a bank in order to obtain the necessary funding. Moreover, firms do not always wish to be subjected to the discipline of continuous public scrutiny, as would happen when funds are obtained through the capital markets.

v. Financial spectrum fillers: In a perfect market where there are no transaction costs and with perfectly available information there would be no role for banks as financial intermediaries. However, since capital markets are not perfect and cannot supply the full range of instruments required by borrowers, banks fill this gap in the spectrum of financial services and are often able to supply specific instruments catering to the individual needs of the customer.

vi. Investors for depositors: Banks accept an investment function for their depositors by assessing investment opportunities and monitoring subsequent investment strategies. By accepting this monitoring task banks help to overcome the inability of lenders (depositors) to exercise control over the behavior of borrowers. Since much of the information is not public, a banking firm enables lenders to select better investments and to monitor their performance at lower costs than would be the case if lenders did so themselves.

vii. Dealers in foreign currency: Banks also handle foreign financing and provide advice on exchange rates and foreign financial market conditions.

12. The functioning of a Debt Recovery Tribunal (DRT) can be divided under various areas, which are given below: < TOP >

Jurisdiction and Cause of Action: The Banks and the Financial Institutions can file Application in a Tribunal in whose limits a Defendant or each of the Defendants, where there are more than one, actually and voluntarily resides or carries on business or personally works for gain.

The Tribunal is conferred with the jurisdiction based on cause of action arising totally or partially, within the jurisdiction of the Tribunal. In other words, Application can be filed in the Tribunal in whose limits the cause of action arises wholly or partly.

Imp leading Provision: By virtue of subsection 3 of Section 19, any Bank or Financial institution other than the applicant's, which is having the subsisting claim against the same borrower, can join the applicant at any stage of the proceedings before passing of the final orders.

Form of Application: All the documents supporting the claim of the Bank like Loan Documents, Security Documents, Acknowledgement of Debt, Statement of Account and other material documents must be enclosed with the application.

Summons to Defendant and Filing of Reply: Section 19 also deals with summons and filing of reply. Subsection 4 of Section 19 requires that the Tribunal shall issue summons to the Defendant requiring the Defendant to show cause within 30 days of service of summons as to why the relief prayed for should not be granted.

Set-off and Claim of the Defendant: Subsections 6 and 7 of Section 19 of the RDBFI Act pertain to Defendant's claim to Set-off. This provision is analogous to the Order VIII Rule 6 of the CPC. Set-off means positive allegation against the Applicant by the Defendant in his defense. This can be included in the defense as Set-off against the Plaintiffs claim.

Counter Claim: The Counter Claim is also provided under Section 19 of the RDBFI Act. Sub sections 8 to 11 of Section 19 deals with the same. Prior to the amendment, a separate suit had to be brought against the Bank in the civil court if the Defendant had Counter Claim with respect to the application filed in the DRT. The effect of Section 31 of the RDBFI Act before the amendment was partial. The suits of the Banks filed for recovery of more than Rs.10 lakh before the Civil Court where the Defendant already fifed the suit could not be transferred completely. The Civil Court had to bifurcate the Counter Claim and had to proceed with the same. It is now possible to entertain and decide the claim and Counter Claim of the Defendant together, on the same application.

Discretion to Pass Interim Orders: The Tribunal is vested with vast powers for passing interim orders by way of injunction or stay or attachment against the Defendant. Under the authority of Subsection 12 of Section 19, the Tribunal issues the interim orders. The Tribunal by issuing injunction can restrain the Defendant from transferring, alienating or disposing off any property or assets belonging to him.

Power to Pass Attachment Order: This provision lays down the power to pass attachment orders. Subsections 13 to 18 deal with this power. The Tribunal on its own or on the application supported by an affidavit, at any stage of proceedings may pass an order of attachment. Before the passing of such an order, the Tribunal should be satisfied that the Defendant is about to dispose off the property or is about to remove it from its jurisdiction, or is likely to cause any damage to the property.

Punitive Powers: The Tribunal can also exercise punitive powers by involving subsection 17 in appropriate cases. Whenever the orders of the Tribunal are not respected and the same are violated or flouted, the Tribunal can on its own motion or on the application made by the party, pass an order for detention of such Defendant in Civil Prison and also for attachment of properties of such person.

Appointment of Receiver: Originally, i.e., before the amendment of the Act, the provision for appointment of receiver before issuing of the Recovery Certificate by the Tribunal was not in existence. A need was then felt and legislation brought about the same by virtue of subsection 18 of Section 19. This sub-section now gives the Tribunal the power to appoint a receiver at any stage, either before or after issuing of the Recovery Certificate.

Interim Orders: The Tribunal is now vested with the powers of parsing interim orders or final orders including orders with regard to the payment of interest from the date on or before which payment of the amount is found due up to the date of realization or actual payment on the application of the Applicant.

Service of Free Copy: Subsection 22 of Section 19 of the Act contemplates service of the free copy of every order of the Tribunal to all the concerned parties. This provision also ensures that the principles of natural justice are followed.

Transfer of Recovery Certificate: Now as per the amendment to the Act, if the Tribunal is satisfied that the property is situated within the jurisdiction of two or more Tribunals then it may send copies of the Certificate for execution to such other Tribunal where the property is situated.

Expeditious Adjudication and Recovery: The main object of the establishment of the Tribunals is to recover the debts due to the Banks and financial institutions. Therefore, the duty of the Tribunal is the adjudication of the claims and issuing certificates for the recovery of the adjudicated debts and realization of the amount specified in the recovery certificate through the Recovery Officer.

Disposal of Application within 180 Days: As the objective of the Act is to recover speedily and expeditiously the claims of the Banks and Financial Institutions; specific provision is made under subsection 24 by fixing a time limit for the disposal of every Application filed before the Tribunal. The time limit so fixed is 180 days and a duty is cast on the Presiding Officer to endeavor for the disposal of the Application within 180 days.

Powers to Pass Orders to Meet Ends of Justice: Before the amendment of the RDBFI Act, the Tribunal was vested with the powers to pass any orders to meet the ends of justice by virtue of Rule 18 of the DRT (Procedure) Rules. The effect of this provision is similar to that of Section 151 of the CPC. Now the Tribunal is given the powers of passing any orders to meet the ends of justice by virtue of the subsection 25 of the Section 19. By exercising the powers under this provision, the DRT is now vested with the powers to pass any orders, which the Act does not expressly provide for.

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