3.1 INTRODUCTION

Banks can differ markedly in their sources of income. Some focus on business lending, some on household lending and some on fee-earning activities. Increasingly, however most banks are diversifying into fee-earning activities. Diversification across various sources of earning is welcomed for, it is claimed diversification reduce risk, whether it does not course depends on how independent of each other the various earnings sources are. During the 1990s, the Indian banking sector witnessed more reforms than most other Indian economy.

In the face of declining net interest margin depository institutions have entered new product areas over the past two decades, moving from traditional lending to areas that generate non-interest revenues. The change is of importance for financial stability. The more unstable is a bank’s earnings stream, the more risky the institution is. The conventional wisdom in the banking industry is that earnings from fee-based products are more stable than loan fee-based activities reduce bank risk via diversification. As compared to the development world, the Indian banking sector apart from the relaying on traditional sources of revenue like, loan making are also focusing on the activities that generate fee income service changes, trading revenue and other types of non-interest income. Now-a-days non-interest income plays an important role in banking revenue in the development world.

3.2 CONCEPT OF INCOME

Edmond Wilson’s good quotation about income. “There is nothing more demoralizing than a small but adequate income.” Generally the income refers with the financial gain accruing over a given period of time. Some definitions of income are as under.
1. “Money earned through employment and investment.”
   **In Simple Word.**

2. “Income is the sum of all the wages, salaries, profits, interests payments, rents and other forms of earnings received... in a given period of time.”¹

3. “Regular payments derived from an investment. This can be interest from cash, dividends from shares or rent from property.”
   **In Simple Word.**

4. “Income refers to consumption opportunity gained by an entity within a specified time frame, which is generally expressed in monetary terms.”
   **By- Wikipedia**

5. “Income is the flow of revenues accruing to a person or nation from labor services and from ownership of land and capital.”²
   **According to an Economic Aspect**

6. “Income is increases in economic benefits during the accounting period in the form of inflows or enhancements of aspects of decreases of liabilities that results in increases in equity, other than that relation to contributions from equity participants.”
   **International Accounting Standards Board.**

7. “Income means
   (A) Money earned during an accounting period those results in an increase in total assets.
   (B) Items such as rents, interests, gifts and commission.
   (C) Revenues arising from sales of goods and services.
   (D) Excess of revenues over expenses and losses for an accounting period.
   **Accounting Dictionary**

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8. “The amount of money received during a period of time in exchange for labor or services from the sale of goods or property or as a profit from financial investments.”

9. “Money received by a person or organization because of efforts or from return on Investments.”

**Investment Dictionary**

### 3.3 TYPES OF BANK INCOME

There are two broad sources of bank income or revenues. One is Interest Income or Fund Based Income and second is, Non-Interest Income or Non-fund Based Income.

#### 3.3.1 INTEREST INCOME/ FUND BASED INCOME

Banks sometimes keep their cash in short term deposit investment such as certificates of deposits with maturities up to twelve month, saving account and money market funds. The cash placed in these accounts earn interest for the business, which is recorded on the income statement as interest income. For others such as an insurance company and financial institutions that generates profit by investing the money it holds for policyholders into interest paying bonds, it is a crucial part of the business.

**MEANING**

1. “Interest income is generated over the life of loans that have been securitized in structures requiring financing treatment (as opposed to sale treatment) for accounting purposes; loans held for investment; loans held for sale; and loans held for securitization.”

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2. “Interest income is generated from what is known as ‘the spread’. The spread is the difference between the interests a bank earns on loans extended to customers. Corporate etc and the interest paid to depositors for the use of their money. It is also earned from any securities that the banks own such as treasury bills or bonds.”

COMPONENTS OF INTEREST/FUND BASED INCOME

Main components of Interest/ Fund Based Income are as under.

3.3.1.1 INCOME FROM LENDING OF MONEY

Generally lending of money refers with disposing of the money or property with the expectation that the same thing will be returned. In other word lending of money is the transfer of securities to a borrower (usually so the borrower can pay back a short term liability), in return for a fee. The borrower agrees to replace them in due course with identical securities and the lender risks/returns of the securities in the meantime.

3.3.1.2 INCOME FROM INVESTMENT (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). An increase in SLR also restricts the bank’s leverage position to pump more money into the economy.

3.3.2 NON-INTEREST INCOME/NON-FUND BASED INCOME

In the face of declining net interest margins, depository institutions have entered new product areas over the past two decades, moving from traditional lending to

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4URL: Http:// www.investmentworld.com/6844/interest-income. Html, 25, July, 2010, 10:00 AM
Areas that generate Non-fund Based Income. The change is of importance for financial stability. The more unstable is a bank’s earning stream, the more risky the institution is. The conventional wisdom in the banking industry is that earnings from fee-based products are more stable than loan-based earnings and those fee-based activities reduce bank risk via diversifications.

MEANING

1. “Non-Fund Based Income is earned by providing a variety of services, such as trading of securities, assisting companies to issue new equity financing, securities commissions and wealth management, sale of land, building, profit and loss on revaluation of assets etc.”

2. “Bank and creditor income derived primarily from fees. Examples of non-interest income include deposit and transaction fees, insufficient funds (NSF) fees, annual fees, monthly account service charges; inactivity fees, check and deposit slip fees, etc. Institutions charge fees that provide non-interest income as a way of generating revenue and ensuring liquidity in the event of increased default rates”

COMPONENTS OF NON- INTEREST/NON- FUND BASED INCOME

Main components of Non-Interest/Non-Fund Based Income are as under.

3.3.2.1 INCOME ON REMITTANCE OF BUSINESS

Apart from accepting deposits and lending money, Banks also carry out, on behalf of their customers the act of transfer of money - both domestic and foreign. - From one place to another. This activity is known as “remittance business”. Banks issue Demand Drafts, Banker’s Cheques, and Money Orders

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Etc. for transferring the money. Banks also have the facility of quick transfer of money also know as Telegraphic Transfer. For Example, In Remittance business, Bank 'A' at a place 'a' accepts money from customer 'C' and makes arrangement for payment of the same amount of money to either the customer 'C' or his "order" i.e. a person or entity, designated by 'C' as the recipient, through either a Branch of Bank 'A' or any other entity at place 'b'. In return for having rendered this service, the Banks charge a pre-decided sum known as exchange or commission or service charge. This sum can differ from bank to bank. This also differs depending upon the mode of transfer and the time available for affecting the transfer of money. Faster the mode of transfer, higher the charges.

3.3.2.1.1 CHEQUE

A cheque, also spelled check, is a negotiable instrument, instructing a financial institution to pay a specific amount of a specific currency from a specified demand account held in the maker/depositor's name with that institution. Both the maker and payee may be natural persons or legal entities. Technically, a cheque is a negotiable instrument 6 instructing a financial institution to pay a specific amount of a specific currency from a specified demand account held in the drawer/depositor's name with that institution. Both the drawer and payee may be natural persons or legal entities. Specifically, cheques are order instruments, as reflected in the formula "Pay to the order of..."—they are not in general payable simply to the bearer (as bearer instruments are), but rather the payee must endorse the cheque, possibly specifying by order to whom it should be paid.

In 1881, the Negotiable Instruments Act (NI Act) was enacted in India, formalizing the usage and characteristics of instruments like the cheque, the bill of exchange and promissory note. The NI Act provided a legal framework for non-cash paper payment instruments in India. 7

7 ibid.
3.3.2.1.2 TRAVELER’S CHEQUE

A Traveler’s Cheque is a printed piece of paper that you sign and use as money when are travelling. It can be replaced if it is lost or stolen. The Traveler’s Cheque issued by a financial institution which functions as cash but is protected against loss or theft. Traveller’s cheques are useful when travelling, especially in case of overseas travel when not all credit and scurried by a person will be accepted. A charge or commission is usually incurred when a person exchanges cash for traveller’s cheque though some issuers provide them free of charge.8

3.3.2.1.3 DEMAND DRAFT

A demand draft, also known as a remotely created check or a tele-check, is a check created by a seller with a buyer’ checking account number on it, but without the buyer's signature. Instead and in place of the signature, the check has verbiage such as "authorized by depositor (the buyer), lack of endorsement guaranteed by XYZ Bank. The seller deposits the check into his or her Bank Account and the check then clears out of the buyer's account.A demand draft or "DD" is an instrument most banks in India use for effecting transfer of money. It is a Negotiable Instrument. A method used by individuals to make transfer payments from one bank account to another. Demand drafts are marketed as a relatively secure method for cashing checks. The major difference between demand drafts and normal checks is that demand drafts do not require a signature in order to be cashed.9

3.3.2.1.4 MAIL TRANSFER/ MAIL ORDERS

This is the mode used when you wish to transfer money from your account in Center 'A' to either your own account in Center 'B' or to somebody else's account. In this mode of transfer, you are required to fill in an application form similar to the

8 URL: http://www.investorwords.com/5055/travelers_check.html#ixzz1JUAkh6Bq 15, May 2010
9 URL: http://www.law.cornell.edu/ucc/1/1-201.html#signed_1-201 Retrieved on July 2010
One for DD, sign a charge slip or give a cheque for the amount to be transferred plus exchange and collect a receipt. The Bank will, on its own, send an order to its branch at center 'B' to deposit the said amount in the account number designated by you.

3.3.2.1.5 RTGS

**Real time gross settlement systems** (RTGS) are a funds transfer mechanism where transfer of money takes place from one bank to another on a "real time" and on "gross" basis. Settlement in "real time" means payment transaction is not subjected to any waiting period. The transactions are settled as soon as they are processed. "Gross settlement" means the transaction is settled on one to one basis without bunching with any other transaction. Once processed, payments are final and irrevocable.\(^\text{10}\)

3.3.2.1.6 NEFT

**National Electronic Fund Transfer** (NEFT) is a nation-wide system that facilitates individuals to electronically transfer funds from any bank branch to any other bank branch in the country. NEFT is an application development to facilitate customers to transfer funds from one bank account to another bank account. It is an efficient, secure, economical, and reliable and expenditure system of fund transfer between banks.\(^\text{11}\)

3.3.2.1.7 SWIFT

The Society for Worldwide Interbank Financial Telecommunication ("SWIFT") operates a worldwide financial messaging network which exchanges messages between banks and other financial institutions. SWIFT also markets software and services to financial institutions, much of it for use on the

\(^{10}\) URL: Http://en.wikipedia.org/wiki/Indian-settlement system, 10, June 2010 11:00 AM

\(^{11}\) URL: http://www.rbi.org.in/scripts/FAQView.aspx?id=60, 10 June, 2010 11: 15 AM
SWIFT Net Network The majority of international interbank messages use the SWIFT network. As of September 2010, SWIFT linked more than 9,000 financial institutions in 209 countries and territories, who were exchanging an average of over 15 million messages per day. SWIFT transports financial messages in a highly secure way, but does not hold accounts for its members and does not perform any form of clearing or settlement. SWIFT does not facilitate funds transfer, rather, it sends payment orders, which must be settled via correspondent accounts that the institutions have with each other. Each financial institution, to exchange banking transactions, must have a banking relationship by either being a bank or affiliating itself with one (or more) so as to enjoy that particular business features.12

3.3.2.2 INCOME FROM THIRD PARTY PRODUCT

Commission or income earned on selling other companies’ products (or third-party distribution business) is emerging as a new revenue source for many banks. Although the fee amounts are still small, they are a valuable contribution to diversifying revenue streams, increasing the mix of non-interest income and also improve profits.

3.3.2.2.1 MUTUAL FUNDS

In simple word Mutual Fund means an investment company that pools the money of a large group of investors and purchases a variety of securities to achieve a specific investment objective. In other word Mutual Fund means a diversified portfolio of securities invested on behalf of a group of investors and professionally managed. Individual investors own a percentage of the value of the fund represented by the number of units they purchased and thus share in any gains or losses of the fund.

Individual investors own a percentage of the value of the fund represented by the number of units they purchased and thus share in any gains or losses of the fund.

3.3.2.2 LIFE INSURANCE PRODUCTS

Here bank earned revenue through the selling of life insurance product on behalf of insurance company. The participation by the bank's customers shall be purely on a voluntary basis. The contract of insurance is between the insurer and the insured and not between the bank and the insured.

3.3.2.3 NON-LIFE INSURANCE PRODUCTS.

Non-life insurance means general insurance. General insurance or non-life insurance policies, including automobile and homeowners policies, provide payments depending on the loss from a particular financial event. General insurance typically comprises any insurance that is not determined to be life insurance. It is called property and casualty insurance. The contract of insurance is between the insurer and the insured and not between the bank and the insured.

3.3.2.4 ISSUED THE CREDIT CARD TO THE CUSTOMER

A credit card is part of a system of payments named after the small plastic card issued to users of the system. It is a card entitling its holder to buy goods and services based on the holder's promise to pay for these goods and services. Credit cards are issued after an account has been approved by the credit provider, after which cardholders can use it to make purchases at merchants accepting that card.

3.3.2.5 INWARD MONEY REMITTANCE BY UAE EXCHANGE & FINANCIAL SERVICES LTD

As the name indicates we are in to financial services. Our core areas of strength include Inward Remittance and Money Changing. We also provide Travel &
Ticketing, Insurance and Package Tour Services and have an IT & Engineering Division.

3.3.2.3 INCOME ON CONTINGENT LIABILITY

A contingent liability is a liability which may or may not arise in the future depending on the happening or non happening of an event.

A contingent liability is a potential liability…it depends on a future event occurring or not occurring. For example, if a parent guarantees a daughter’s first car loan, the parent has a contingent liability. If the daughter makes her car payments and pays off the loan, the parent will have no liability. If the daughter fails to make the payments, the parent will have a liability.

3.3.2.3.1 LETTER OF CREDIT

A Letter of credit means a document issued by a bank that guarantees the payment of a customer’s draft; substitutes the bank's credit for the customer's credit A letter from a bank guaranteeing that a buyer's payment to a seller will be received on time and for the correct amount. In the event that the buyer is unable to make payment on the purchase, the bank will be required to cover the full or remaining amount of the purchase. A standard, commercial letter of credit (LC) is a document issued mostly by a financial institution, used primarily in trade finance, which usually provides an irrevocable payment undertaking.

3.3.2.3.2 BANK GUARANTEE

A guarantee from a lending institution ensuring that the liabilities of a debtor will be met. In other words, if the debtor fails to settle a debt, the bank will cover it. A bank guarantee enables the customer (debtor) to acquire goods, buy equipment, or draw down loans, and thereby expand business activity.\(^ {13} \)

\(^ {13} \) URL: http://www.investopedia.com/terms/b/bankguarantee.asp 18, July 2010, 5: 50 PM
3.3.2.4 INCOME ON GOVERNMENT BUSINESS

In present age apart from rendering all other Personal banking services to its customers/public, every bank in India also works as Agency Bank for undertaking various types of Govt. Business viz.

Pension Payment
Collection of PPF and Payment of PPF
Collection of Government Bonds
Collection of Senior Citizen Deposits
Collection of Various Taxes, like CBDT, Indirect tax Excise and VAT
Receipts/payments work of Postal/Railways
Treasury/Sub-Treasury business
Franking of Stamps of various documents
Collection of Stamp Duty

3.3.2.5 INCOME ON WEALTH MANAGEMENT

Wealth management is an investment advisory discipline that incorporates financial planning, investment portfolio management and a number of aggregated financial services. High net worth individuals, small business owners and families who desire the assistance of a credentialed financial advisory specialist call upon wealth managers to coordinate retail banking, estate planning, legal resources, tax professionals and investment management. Wealth management can be provided by large corporate entities, independent financial advisors or multi-licensed portfolio managers whose services are designed to focus on high-net worth customers. Large banks and large brokerage houses create segmentation marketing-strategies to sell both proprietary and nonproprietary products and services to investors designated as potential high net-worth customers. Independent wealth managers use their experience in estate planning, risk management, and their affiliations with tax and legal
specialists, to manage the diverse holdings of high net worth clients. Banks and brokerage firms use advisory talent pools to aggregate these same services.

3.3.2.5.1 INCOME FROM THIRD PARTY PRODUCT

Commission or income earned on selling other companies’ products (or third-party distribution business) is emerging as a new revenue source for many banks. Although the fee amounts are still small, they are a valuable contribution to diversifying revenue streams, increasing the mix of non-interest income and also improve profits. Third party products like...

1. Mutual Funds
2. Life Insurance Products
3. Non-Life Insurance Products

3.3.2.5.2 STOCKS & STOCKS TRADING

Income from stocks and stocks trading are the component of wealth management. Now-a-days banks are offering Stock broker & commodity brokers engaged in offering, share broking services, commodity trading services, online commodity trading services, e-commodity trading services and share trading services.

3.3.2.5.3 EQUITY LINKED INVESTMENT

Equity linked products are structured investment tools which enable you to generate yields through investing in stock options. Therefore, the return is based on the performance of a single stock, or in some case, a basket of stocks, or a stock index. Since the products are closely related to the performance of listed stocks, the risks involved resemble investment in the underlying stocks. By investing in an equity linked product, you agree to purchase or sell listed stocks at a future date for an agreed price. The number of shares or the financial gain and
loss customers will receive at maturity depends on the price performance of the stocks selected.

3.3.2.5.3 STRUCTURED SAVING PRODUCTS

Structured products are synthetic investment instruments specially created to meet specific needs that cannot be met from the standardized financial instruments available in the markets. Structured products can be used: as an alternative to a direct investment; as part of the asset allocation process to reduce risk exposure of a portfolio; or to utilize the current market trend.

Interest in these investments has been growing in recent years and high net worth investors now use structured products as way of portfolio diversification. Structured products are also available at the mass retail level - particularly in Europe, where national post offices, and even supermarkets, sell investments on these to their customers.

1. Flow through share limited partnership
2. Funds of income Trusts
3. Funds of Hedge Funds
4. Highly yield bond portfolios
5. Covered call writing
6. Split share corporations

3.3.2.5.5 STRUCTURED INVESTMENT PRODUCTS & DERIVATIVES

A structured investment product combines two products into one, offering return potential on one or both of the products involved. One product is generally a money market account that pays a fixed rate periodically and the other is put into an option that offers a variable rate of return. This allows the structured investment product to produce a return even when the markets fall.
Uncertain economic times, a structured investment product protects your capital investment and provides you with earning opportunity. In fact, structured investment products are fixed-term investments, meaning you get to decide the minimum and maximum earning potential of the product you choose. In some cases, the rate is linked to an underlying benchmark, such as interest rates, commodities or foreign exchange markets.

3.3.2.5.6 FOREIGN EXCHANGE

Banks generated the revenue from foreign exchange transaction. Here difference between forward exchange contract transaction and actual transaction. Foreign exchange refers with the system by which the type of money used in one country is exchanged for another country’s money, making international trade easier.

3.3.2.5.7 INCOME FROM ALTERNATIVE INVESTMENT PRODUCTS

Alternatives are typically investments that aim to generate alpha, driven by manager skill through the use of a wide range of unconventional instruments, not available in traditional markets. They provide diversification and may enhance portfolios by improving returns and lowering risk. In addition, their low correlation with traditional asset classes (such as equities and bonds) means that alternative investments may help preserve capital when traditional markets fall in value. Product like….

1. Hedge Funds
2. Private Equity
3. Real Estate

3.3.2.5.8 SOLD OF PRECIOUS METALS

Banks are also generated the income from selling of precious metals like silver and gold coins.
3.3.2.6 INCOME FROM OTHER SOURCES

3.3.2.6.1 DEMAT ACCOUNT

Demat account is a safe and convenient means of holding securities just like a bank account is for funds. Today, practically 99.9% settlement (of shares) takes place on demat mode only. Thus, it is advisable to have a Beneficiary Owner (BO) account to trade at the exchanges.

The term Demat, in India, refers to a dematerialized account for individual Indian citizens to trade in listed stocks or debentures, required for investors by The Securities Exchange Board of India (SEBI). In a demat account, shares and securities are held electronically instead of the investor taking physical possession of certificates. A Demat Account is opened by the investor while registering with an investment broker (or sub broker). The Demat account number is quoted for all transactions to enable electronic settlements of trades to take place.14

Access to the Demat account requires an internet password and a transaction password as well as initiating and confirming transfers or purchases of securities. Purchases and sales of securities on the Demat account are automatically made once transactions are executed and completed.

3.3.2.6.2 DIPOSITORY PARTICIPANTS ACCOUNT

DP means Depository Participant of CDSL (Central Depository Services (India) Limited). A DP account is necessary if you intend to hold your securities and/or trade in the electronic form. The DP account must be opened by you with a Depository Participant, which may or may not be your broker.

In India, a Depository Participant (DP) is described as an agent of the depository. They are the intermediaries between the depository and the investors. The

Relationship between the DPs and the depository is governed by an agreement made between the two under the Depositories Act. In a strictly legal sense, a DP is an entity who is registered as such with SEBI under the subsecton 1A of Section 12 of the SEBI Act. As per the provisions of this Act, a DP can offer depository-related services only after obtaining a certificate of registration from SEBI. SEBI (D&P) Regulations, 1996 prescribe a minimum net worth of Rs. 50 lakh for stockbrokers, R&T agents and non-banking finance companies (NBFC), for granting them a certificate of registration to act as DPs. If a stockbroker seeks to act as a DP in more than one depository, he should comply with the specified net worth criterion separately for each such depository. No minimum net worth criterion has been prescribed for other categories of DPs; however, depositories can fix a higher net worth criterion for their DPs.

3.3.2.6.3 OTHER SOURCES

Banks are generated income from other sources like, Incidental Charges, profit on sale of investment and recovery in prudential Wright off Account.

3.4 FOUR COMPONENT OF NON-FUND BASED INCOME

<table>
<thead>
<tr>
<th>Name of Non-Fund Based Income</th>
<th>Example</th>
</tr>
</thead>
<tbody>
<tr>
<td>Fiduciary Income</td>
<td>- Administering Investment for others</td>
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<tr>
<td></td>
<td>- Gross Income from services rendered by the bank’s trust</td>
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<td>Service charges on Deposit Account</td>
<td>- Maintenance of Deposits Account</td>
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<td>- Failure to meet minimum balance</td>
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<td><strong>excess check writing</strong></td>
<td>- Withdrawals from non-transaction Account</td>
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<td>- Early withdraw or closure fee</td>
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<td>- Dormant Account</td>
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<td>- Extensive activity</td>
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<td>- ATM Usage</td>
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<td></td>
<td>- Bounced Check Charges and other fee</td>
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<tr>
<td><strong>Trading Revenue</strong></td>
<td>- Net gain or loss from trading cash instrument</td>
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<td></td>
<td>- Off balance sheet derivatives contracts</td>
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<tr>
<td></td>
<td>- Sales of assets and other financial instruments</td>
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<td></td>
<td>- Revaluation to carrying value of assets and reliabilities due to marking to market</td>
</tr>
<tr>
<td></td>
<td>- Revaluation of interest rate</td>
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<td>- Foreign Exchange</td>
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<td>- Equity Derivatives</td>
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<td></td>
<td>- Commodity and other contract due to marking to Market</td>
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<tr>
<td></td>
<td>- Incidental Income related to purchase and sale of assets and liabilities</td>
</tr>
<tr>
<td><strong>Fee and Other Income</strong></td>
<td>- Service Charges</td>
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<tr>
<td></td>
<td>- commission</td>
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<td></td>
<td>- Safe Deposit Boxes</td>
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<td>- Insurance Sales</td>
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<td>- Bank Draft</td>
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<td>- Money Order</td>
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<td>- Bill Collection</td>
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<td>- Saving bond Redemption</td>
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<td>- Execution of acceptances and</td>
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<td>letters of credit</td>
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<tr>
<td>- Mortgage Servicing Fees</td>
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<td>- Notary</td>
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<td>- Consulting and Advisory Services</td>
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<td>- Credit Card Fees</td>
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<td>- Merchant Credit and Charges</td>
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<td>- Rental Fees</td>
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<td>- Loan Commitment Fees</td>
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<td>- Net Gain on Sales of Real Estate</td>
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<tr>
<td>- Foreign Transaction</td>
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</table>

**Source:** Consolidated Report of Condition and Income, Call Report

### 3.3.2.8 CONCLUSION

Non-interest income is derived from the execution/processing business, the advisory business and any principal business that does not appear on the balance sheet. Financial institutions that wish to maximize execution/processing income depend on volume and efficiency for profits. To be successful, the trade center and the back office must be well coordinated and function in an efficient manner. In the face of declining net interest margins, depository institutions have entered new product areas moving from traditional lending to areas that generate non-interest revenues.
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