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The banking sector is the lifeline of any economy. It is one of the important financial pillars of the financial system, which plays a vital role in the success or failure of an economy. Banks are one of the oldest financial intermediaries in the financial system. The banking system is the fuel injection system which spurs economic efficiency by mobilizing savings and allocating them to high return investment. The banking system reflects the economic health of the country. In this reference, researcher has discussed concept of banking sector, historical development of banking sector, various development phases of the bank, types of banks, and functions of modern banking sector.
Chapter-1
Banking in India

1.1 Introduction

Generation of new ideas and their application for productive uses is an important component in the engine for growth and development. Human talent has paved the way for high economic value creation, behind the generation of ideas, innovations, new technologies and robust financial systems. Banking system performs important role in economy of a nation. Banking systems transform financial systems. In fact, bank is lifeblood of an economy. A banking institution performance is seen as the exact copy of economy activities of the nation as a healthy banking sector system acts as the basic facts of solid economic and industrial growth of a nation.

The development of communications, the process and spread of science and growth of economic and political institution in the 20th century, the Indian economy was passing through a volatile period of stability around the five decades had elapsed since the Indian muting and the social industrial and other infrastructure had improved. The wide popularity has been a long year back with great trial and error. As per current trend of economy, people must need a reliable platform; which is adopted by all banks. Indian small banks established several ethics and religious communities.

The electronic age has a meant several changes for banking. Firstly the delivery channels have increased leading to lower cost and wider verity of services. The major changes faced by the banking segment on its path. Here is that the banking sector has now completed all its transaction computerized and also adopted of the internet in the banking sector. The
innovation of the modern era is also inspired by banks. Banks implement the innovative practices and provide to the customers reliable services, here is the study relating to the customer perspective of innovative banking practices in Gujarat region. In this regard, in the present chapter, the researcher has discussed concept of banking, history and development of banking sector, types of bank and functions of modern banking.

1.2 Origin of word “BANK”

The word “Bank” is derived from the Italian word “Banco”, it means “Desk/ Bench” used during the Renaissance by Florentine bankers, who used to make their transaction above a desk covered by a green tablecloth. However, there are traces of banking activity even in ancient items.

In fact, the word traces its origin back to the ancient Roman Empire, where money lenders would set-up their status in the middle of enclosed country yards called “Macella” on a long bench called a “Bancu” from which the words “Banco” and “Bank” word derived.

The earliest evidence of the word “Bank” is also derived from “Trapezus” a silver drachms coin from ancient Hellenic colony trepezus on the black sea, modern trabzen C.350-325 BC presented in the British museum in London1. The coin shows a banker’s table (Trapeza) laden with coin, a pun on the name of the city. In fact, even today in modern Greek the word” Trapeza” means both a table and a bank.

The word “ Bank” is originally derived from German word “Bank” meaning a joint stock fund which was Italianized into “Banco” when the German’s were master of a great part of Italy2. This appears to be more possible.
1.3 **Definition of banking**

“Banking means the accepting, for the purpose of lending or investment, of deposits of money from the public, repayable on demand or otherwise and withdrawal by cheque, draft, order or otherwise.”

- The Banking Regulation Act, 1949, Section 5(b)

“Bank is a manufacturer of credit and machine for facilitating exchange.”

- Horace White

“Bank means a bench or table for changing money.”

- Greek History

“A bank is an establishment which makes to individuals such advances of money or other means of payment as may be required and safely mode and to which individual entrust money or means of payment when not required by them for use.”

- Prof. Kintey

“Bank is an institution that deals in money and its substitution and provides other financial services. Banks accept deposits and make loans and derive a profit from the difference in the rates paid and charged, respectively. Some banks also have the power to create money.”

- Encyclopedia Britannica

“Banking in the full modern sense, of talking money on deposit and lending it out on interest, is of comparatively recent origin.”

- The international standard

“Banks are institutions, whose debts, usually referred to as bank deposits are commonly accepted for final settlement of other people’s debts.”

- Prof. Sayers
“Bank is a corporation, deals with cash and to receive the deposits of money and gives a loan to third parties.”

-Sunil Lohiya

“Bank an institution which accepts deposits, makes business loans and offered related services.”

-Sunil Lohiya

1.4 **The history of banking- -World**

The history of banking takes us back to when man facts the needs to exchange goods and services. It is known as “Barter System”. The Barter system was one of the earliest exchanges of goods when money was not invented in those times.

The history of bartering can be traced back to 6000 BC. It is believed that barter system was introduced by the tribes of “Mesopotamia”\(^\text{10}\) This system was then adopted by the Phoenicians, who bartered their goods to people in other cities located across the oceans.

History of banking in the world has been discussed under six parts namely:

1.4.1 Banking in Mesopotamia.
1.4.2 Banking in China.
1.4.3 Banking in England.
1.4.4 Banking in Italy.
1.4.5 Banking in Greece.
1.4.6 Banking in United States of America.

1.4.1 **Banking In Mesopotamia (Babylon- Baghdad)**

Mesopotamia was a city of Baghdad, the remains of which are founded in present day Al-Hillah Babil province, Iraq. The first banks were probably the religious temple of the ancient world and were probably established sometimes during the third millennium BC banks
probably predated the invention of money deposits initially consisted of grain, cattle, agriculture implementation and metals such as gold, the 18th century (1726-1686) BC in Babylon that were made by temple priests/monks to merchants by the time of Hammurabi’s code, banking was well enough developed to justify the promulgation of laws governing banking operations\(^\text{11}\).

### 1.4.2 Banking In China

Chinese financial institutions were conducting all major banking functions including the acceptance of deposits, making of loans, issuing notes, money exchange and long distance remittance of money by Song Dynasty (960-1279). In 1024, the first paper currency was issued by State in Sichuan\(^\text{12}\).

The Institutions of “Piaohao” and “Qiazhuang” more often co-operated than completed in China’s financial market “ Piaohao” was early Chinese banking institution, it is also known as “ Shanxi Bank” because they were owned primarily by natives of “Shanxi. The first “Piaohao” originated from the “Xiyuecheng” Dye Company of “Pingyao” to deal with the transfer of large amounts of cash from one branch to another of the company many branches around china.

“Xiyueecheng Company” it became so popular in 1823. Rishengechang Piaohao in the next thirty years, eleven “piaohao” were established in Shanxi province in the countries of “Qixian taigu” and Pingyao by the end of the nineteenth century thirty two piaohao with 475 branches were in business covering most of China, Li Hongzhang one the leaders of the self strengthening movement made serious efforts to create a foreign Chinese joint bank in 1885 and again in 1887\(^\text{13}\). The imperial bank China , China’s first modern bank opened for business in 1847, 1905 China’s first Central Bank was established as the bank of the Board
of Revenue, three years later, its name was changed to the “Great Qing Government Bank”\textsuperscript{14}.

### 1.4.3 Banking in England

Banking system was working during the reign of Edward-II. Edward of Carnarvan was king of England from 1307 to 1327. It was taken up by a Royal exchanger for the benefit of the crown in England a gold Smith prepared ground of modern banking.

The bank of England was started in 1694; it was founded by Scotsman William Paterson to act as the English government’s banker. He proposed a loan of £1.2m to the Government in return the subscribers would be incorporated as “The Governor and company of the bank of England” with long term banking privileges including the issue of notes\textsuperscript{15}.

The Royal Charter was granted on 27, July through the passage of the Tonnage Act of 1964, The first Governor Sir John Houblon, who is depicted in the £50 note issued in 1994. The governor and company of the bank of Scotland were issued principles of trading with bank in 1964\textsuperscript{16}.

The parliament of Great Britain’s introduced Acts of Union 1707 in also bank of England Act issued in 1708 and 1709 respectively. England bank followed the bank notes Act 1833 and currency and bank notes Act 1914, in 2008 banking Act was renewed as a consequence of the financial crisis of 2007-08 \textsuperscript{17}.

### 1.4.4 Banking in Italy (Rome)

The Christian prohibition on usury eventually provides an opportunity for bankers of another’s religion. Italy was the growth of European banking. It was Ital that the present science of baking and knowledge of the double entry system was developed. The Italian merchants established the business houses and powerful banks.
The first bank was established in Italy was San Giorgio Bank in 1148 in Genoa and Vitale in Venice in 1157. The thirteenth century Tuscans and fourteenth century Florentines set up a close business community in Cahors in competition with the Lombard’s. The cascade Medici at Florence represents the apotheosis of Italian bank of this period.

The Monte dei Paschi dei seine in 1472 was granted the right to collect revenue from the annual leasing of paschi for which is issued shares to build its capital from which in turn it made loans on interest. In Fourteenth century there were discount banks and foreign banks were involved.

The first State bank opened in 1587 under the name of Banco-de-Rialto. Bank of Amsterdam under the guarantee of the city of Amsterdam. It served as a model for another. It was the first to use money of account or ‘Banco-Money’ in terms of which receipts were handed over to deposits in the form of written titles showing the value of deposits.

Banco-de-Giro was set up in 1619 to develop the use of Contadi-del-banco ancestors of the cheque and the bank note. In Italy ‘the Bancad’ Italia performed the governments central Bank.

1.4.5 Banking in Greece

Banking activities in Greece are more varied and sophisticated than in any previous society. Private entrepreneurs as well as temple and public bodies, now undertake financial transaction. They take deposit, make loan, change money from one currency to another and test coins for weight and purity.

They even engage in book transaction and moneylending activities. In Greek city, it is found that people accept payment and give credit basis money transaction.
Rome, with its genius for administration adopts and regularizes the baking practices of Greece. By the 2nd century AD a debt can efficiency be discharged by paying the appropriate sum into a bank and public notaries are appointed to register such transactions.

1.4.6 Banking in United State of America

American bank developed in 18th centaury. First bank of the United States was established in 1781 named the bank of North America. Robert Morris as superintendent of finance helped to open Bank of North America.

In 1791, a former aide to Morric Alexander Hamilton, the secretary of the treasury made a deal to support the transfer of the capital from Philadelphia to the banks of the Potomal in exchange for southern support for his bank project. As a result, the first Bank of the United States (1791-1811) was chartered by congress in that same year.

The second Bank of United States was established in 1816. It was basically a copy of the first bank, with branches across the country. Andrew Jackson, who became president in 1828, denounced it as an engine of corruption that benefited his enemies his destruction of the bank was a major political issue in the 1930s and shaped the second party system as democrats in the states opposed banks and Whigs supported them.

1.5 History of Indian banking

History of Indian banking has been discussed under four periods namely:

1.5.1 Ancient India.
1.5.2 Buddhist period.
1.5.3 Muslim period.
1.5.4 British period.
1.5.1 Ancient India

The origin of bank in India back to the Vedic period. There is a reference in the Vedic literature to lending money was a quite common as a side business. Later, during the time of the Smritis, which followed the Vedic period, and the Epic age, banking became a full-time business and got diversified with bank performing most of the functions and provide different kind of various services. The Vaish community, who conducted banking business during this period, accepted deposits from the public, granted loans against pledges and personal security.

Still later, that is, during the Buddhist period, banking business was decentralized and became a matter of volition. Consequently, Brahmins and Kshatriyas, who were earlier not permitted to take to banking as their profession except under exceptionally rare circumstances, also took to it as their business. During this period, banking became more specific and systematic and bills of exchange came in wide use. "Shresthis" or bankers became influential in society and very often acted as royal treasurers.

1.5.2 Buddhist period

The Buddhist period banking business was decentralized and became a matter of volition. Brahmins and Kshatriyas, who were earlier not permitted to take to banking as their profession except under exceptionally rare circumstances, banking in this period became more specific and systematic and bills of exchange came in wide use. "Shresthis" or bankers became influential in society and very often acted as royal treasurer.

1.5.3 Muslim period:

The Muslim period, since the Muslims rulers believed in the Quran and Charging interest as "Haraam” or a great sin. The Mughal period, particularly during the secular and settled reign of Emperor Akbar who
gave the much-needed political stability and strength to the country. During Jahangir's, private banking further developed and it is recorded that there were many enterprising bankers functioning in the country at this time. During Shahjahan's reign also banking prospered without interruption and large banking houses were established at important trading centers in the country. During the Aurangzeb period, he adopted a negative approach towards money lending and banking.

Further, during the Jahangir's reign, private banking further developed and it is recorded that there were many enterprising bankers functioning in the country at this time. During Shahjahan's reign also banking prospered without interruption and large banking houses were established at important trading centers in the country. However, as a staunch practitioner of the quranic injunctions, Aurangzeb adopted a negative approach towards money lending and banking. Even so, some of the sagacious indigenous bankers were very influential in the country's life.

1.5.4 British period (1770-1942)

The British period, during the seventeenth century witnessed the coming into India of the English traders. Their own agencies and houses established by English traders. In this era, the East India Company came to favour the establishment of the banking institutions patterned after the western style.

The Bank of Hindustan was established in 1770. The first Joint Stock Bank founded by M/s. Alexander and Company. This bank failed in 1832. The Bengal Bank and the Central Bank of India were established in 1785. The Bank of Bengal was established in Calcutta in 1806 under the name of Bank of Calcutta. The Bank of Bombay and the Bank of Madras were established in 1840 and 1843 respectively. All banks were also powered to issue notes. The paper currency Act, 1862, was issued
by the Government of India. A new bank of the same name was constituted under the Indian company Act, 1866. The Presidency Banks Act of 1876 placed certain restrictions on the functioning of these banks, which were forbidden from negotiating foreign bills. They were also forbidden from giving advances for a period exceeding six months\textsuperscript{21}.

In 1898, the Fowler Currency Committee favored the establishment of a Central bank in the country. The Chamberlain Commission in 1913, suggested the appointment of a committee to examine the whole issue. The Imperial Bank of India was established in 1921. At the time of the amalgamation, the three Presidency Banks had a total of 70 branches, total paid up capital of Rs. 3.75 crores and reserves totaling Rs. 3.5 crores\textsuperscript{22}.

In the 19\textsuperscript{th} Century, most of Indian Banks were established under the regulation of The Royal Commission and The Industrial Commission in 1914 and 1918 respectively. In 1919, Sir B. N. Sharma had moved a revolution in the Imperial Legislative Council asking the Government for appointing a banking committee.

The Reserve Bank of India Act passed in 1934 relating to scheduled banks meant considerable regulation of the hitherto irregulative commercial banking system in the country. Banking company (Control) ordinance, 1948 and the Indian company (Second amendment) Act, 1942 which provided necessary regulation and framework of operating bank.

1.6 **Bank development during period (1942-1948)**

The war years witnessed to increasing number of scheduled bank in the country, during this period Bharat Bank Ltd, the Hindustan Commercial Bank, the United Commercial Bank and the Travancore Bank Ltd were established. Above first three bank owned by well known
industrial houses of Dalmias, Singhanian and Birlas. The Bharat bank Ltd. was merged with Punjab National Bank Ltd. in 1951. 23.

1.7 First phase (1948-1968)

First phase (1948-1968) has been discussed under three broad areas namely:

1.7.1 Before Independence (pre-period).
1.7.2 After Independence (post-Period).
1.7.3 Five year plan era.

1.7.1 Before Independence (Pre-period)

Further, during this period Indian banking system inherited the pattern of British banking system. There were many Joint-stock companies operate together a banking activities. Even the financing activities of these banks were confined to the exports of jute, tea and traditional industries like textiles and sugar. There was no uniform law governing banking activities.

1.7.2 After Independence (Post-period)

The banking regulation act passed in 1948 provided legal framework for the regulation of the banking systems by the RBI. The Act prohibited his use of word ‘Bank’ by financial companies. The RBI was a greater power of controlled over the bank. There were 620 banking companies, including big or small, scheduled or non- scheduled operating mostly in State capital urban states. The number of branches was 4263, total deposits and advances were Rs. 997cr. and Rs.518 cr., investments were Rs. 376 crore. Imperial Bank of India was the biggest bank in those days with 433 branches. The present day subsidiaries of the state Bank of India were independent banking companies mostly in the former princely states. Besides the Indian Banks, there were 15 Exchange bank 24
(Foreign Banks) were established in big cities only and they were dealing mostly with international banking i.e. financing the export and import of commodities.

The Banking System at the time of independence was deficient in many respects. The banks were largely urban-oriented and remained beyond the reach of the rural population. A large percentage of the rural population had to depend on the moneylender as their main source of credit. Banks’ rural penetration was grossly inadequate, as agriculture was not considered an economic proposition by banks in those days. Thus, the agricultural sector, the crucial segment of the Indian economy was not supported by the banking system in any form. Moreover, security oriented lending was the order of the day. Only 4% of the total advances were made without any security\textsuperscript{25}. Another serious deficiency was that the focus of banks was entirely on short-term credit. There were no sources of long-term finance worth the name. There was neither well developed capital market, nor any term-lending institution except for the industrial finance corporation of India, set up in 1948 \textsuperscript{26}.

1.7.3 Five year plan era

The Banking segment came into the existence in the year 1950 to 1960 to give rise to Indian economy development. This period was witnessed of the legal frame work for the banking industry. This was the first initial step towards the development which had to change the future scenario.

“All Indian rural credit survey committee” recommended the creation of the state partnered and state sponsored bank by the taking over the Imperial bank of India and integrated with it, the former state owned or state associated bank. An act was accordingly passed in the Parliament in May, 1955 and SBI Act was passed in 1959, enabling the SBI India to take over eight former state associated banks as its subsidiaries.
During this period, 566 commercial banks were established in December 1951, out of 566 banks, 92 banks were scheduled and the remaining 474 were non-scheduled banks.27

1.8 **Second phase (1969-1991)**

This period witnessed socialization of banking. Commercial banks were viewed as agents of change and social control of banks. Banks were nationalized two times 14 in 1969 and 6 in 1980 in order to control the heights of the economy in conformity with national policies and objectives.28

This period saw the birth and growth of what is now termed as “directed lending” by banks. It also saw commercial banking spreading to far and wide areas in the country. This phase begun with appointment of banking commission in 1969 which was recommended changes in structure, procedure and policy of the Indian banking system. The banking commission did not have much time to complete its task as it was overtaken by Swift politics economic development, which culminated in the nationalization on 4th July 1969 of the 14 major Indian scheduled bank in the private sector and 15th April 1980, six more private sector banks were nationalized.29 Nationalization was seen as a major step to ensure adequate credit flow into genuine productive arrears in conformity with plan priorities.

Second phase (1969-1991) has been discussed under five parts namely:

1.8.1 After nationalization.
1.8.2 Branch expansion.
1.8.3 Deposit mobilization.
1.8.4 Credit operations.
1.8.5 Social banking.
1.8.1 After Nationalization

The main aims of nationalization were growth, reduction in region imbalance of economic activity and to make the banking system reach out to the small man. Thus the main aim was to bring large areas of economic activity within the organized banking systems. The two significant aspects of nationalization were therefore rapid branch expansion and channelizing credit according to priorities. Indian Baking was relatively sophisticated with a large range of branches, huge deposit and extensive credit operation.

1.8.2 Branch expansion

Due to nationalization, there is a rapid growth in branch expansion. There are fundamental changes in branch expansion policy of the banks, now banks open their branches even in rural area. Branches perform all the activities as per direction and according to the policies of the apex body. The details of the progress of branch network during the period have been summarized in the table below.

Table no. 1.1
Number of branches of public sector banks

<table>
<thead>
<tr>
<th>Year</th>
<th>Total No. of Branches</th>
<th>Rural Branches</th>
<th>Semi-urban Branches</th>
</tr>
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<tbody>
<tr>
<td></td>
<td></td>
<td>%</td>
<td>%</td>
</tr>
<tr>
<td>1969</td>
<td>8262</td>
<td>100</td>
<td>1833</td>
</tr>
<tr>
<td>1980</td>
<td>32419</td>
<td>100</td>
<td>15105</td>
</tr>
<tr>
<td>1991</td>
<td>60220</td>
<td>100</td>
<td>35206</td>
</tr>
</tbody>
</table>

Source:-Various issues of Reserve Bank of India Bulletins and Statistical Tables relating to Banking in India.
Above table no. 1.1 and graph no. 1.1 show that total no. of branches increased near about eight fold between 1969 to 1991 and the bulk of the increase was on account of rural branches, which increased from less than two thousand in 1969 to over 35000 in 1991. The percentage share in the total number of branches of rural and semi urban branches from 22% and 40% in 1969, 47% and 25% in 1980 and 58% and 19% in 1991. A substantial part of the increase in branch expansion took place in the first decade after nationalization. The share of rural and semi urban branches together in the total number of branches from 62% in 1969 to 77% in 1991. The impact of this phenomenal growth was to bring down the population per branch from 60000 in 1969 to about 14000. Thus, one of the objectives of nationalization i.e. to make banking reach out to the small man in rural and semi urban areas may be said to have been served to a great extent. Even on the eve of banking reforms, the bank branch network was widespread.
1.8.3 Deposit Mobilization

Other objective of branch expansion was mobilized deposit, national saving both actual and potential and channelized in proper planning to invest in priority level. Deposits mobilized during 1969 to 1991 is shown in the below table.

Table no. 1.2
Deposit mobilization (Rs. In Crore)

<table>
<thead>
<tr>
<th>Year</th>
<th>Total Deposits</th>
<th>Term Deposit</th>
<th>Saving Deposits</th>
</tr>
</thead>
<tbody>
<tr>
<td>1969</td>
<td>5173</td>
<td>3280</td>
<td>1524</td>
</tr>
<tr>
<td>1980</td>
<td>37988</td>
<td>19253</td>
<td>10937</td>
</tr>
<tr>
<td>1991</td>
<td>230758</td>
<td>128768</td>
<td>56902</td>
</tr>
</tbody>
</table>

Source:- Various issues of Reserve Bank of India Bulletins and Statistical Tables relating to Banking in India.

Graph no. 1.2
Deposit mobilization

Above table no. 1.2 and graph no. 1.2 indicate that between 1969 and 1980, total deposits increased more than seven times and between 1980 and 1991, the increase was far more than five times. These two categories of deposits recorded a handsome increase in each of the
periods 1969-1980 and 1981-1991. The share of time deposits was on an average 56% of the total deposits for the period 1969-1991, while the average share of savings deposits was 27%. This is the result of both widening and deepening of the branch network by banks.

1.8.4 Credit operations

The Reserve bank of India’s credit policy over the years laid increasing emphasis on channeling of bank credit to preferred sectors and borrowers of small means. Annual targets were laid down for lending to priority sectors as a whole with sub targets for weaker section of the society. It was also subdivided major portion of deposit in rural and semi urban areas. Credit operations during 1969 to 1991 have been shown in the below table.

Table no.1.3
Credit operations (Rs. In Crore)

<table>
<thead>
<tr>
<th></th>
<th></th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>Bank Credit</td>
<td>3729</td>
<td>25371</td>
<td>125592</td>
</tr>
<tr>
<td>Priority sector</td>
<td>659</td>
<td>8501</td>
<td>45425</td>
</tr>
<tr>
<td></td>
<td>(18%)</td>
<td>(33%)</td>
<td>(36%)</td>
</tr>
<tr>
<td>Agriculture sector</td>
<td>258</td>
<td>3584</td>
<td>18157</td>
</tr>
<tr>
<td></td>
<td>(39%)</td>
<td>(42%)</td>
<td>(42%)</td>
</tr>
<tr>
<td>small scale industry sector</td>
<td>347</td>
<td>3229</td>
<td>18150</td>
</tr>
<tr>
<td></td>
<td>(52%)</td>
<td>(37%)</td>
<td>(42%)</td>
</tr>
</tbody>
</table>

Source: - Various issues of Reserve Bank of India Bulletins and Statistical Tables relating to Banking in India, 2009-10.
Above table and graph show that the bank credit increased about seven times between 1969 and 1980 and about five times between 1980 and 1991. The share of priority sector in total bank credit increased from 18% in 1969 to 36% in 1991. The share of small-scale industry sector was 52% in 1969 showed a relative decline to 37% in 1980 and was increasingly 42% in 1991.

1.8.5 Social Banking

Social banking means the banking instrument for promoting socio-economic objectives. In the seventies, banking policy was reoriented for securing a progressive reduction in income concentration of economic power and class disparities. For attaining the objectives of social banking, special institutions and schemes were sponsored by the government of India and the RBI.

Integrated rural development program and programmes for self employment of educated unemployed youth, money of the poverty alleviation programmes in the nature of mass lending schemes were adopted by the banking system for financing

The Narsimham committee, which went into these problems in 1974, recommended the establishment of regional rural bank under the RRBs Act, 1975 30.
1.9 Third phase (1992-2002)

After 1991 “LPG” policy has opened the new doors for the development of the banking segment. The Globalization, Privatization and Liberalization became only possible when there is the development of highly mobile capital system, as a result the complex financial system demolished to survive in today's competitive world. It is really very essential to make development for customer satisfaction and also to concentrate on the marketing features so as to make the development in the best way.

The strong winds indicate that the global scenario has been changed. The capital market has been faced lots of changes for following factors:

- Adoption of information technology.
- Marketing policy.
- Competition oriented services and so on.

Third phase (1992-2002) has been discussed under seven parts namely:

1.9.1 The reform process.
1.9.2 Banking reforms.
1.9.3 Narsimham committee-I.
1.9.4 Narsimham committee-II.
1.9.5 Verma committee.
1.9.6 Khan committee.
1.9.7 Positive response of reforms.

1.9.1 The Reform Process

The main economic reforms are.

- Deregulation of license regimes permits systems from the production of domestic trade.
- Over control influencing a balance of payment pressures.
- Integration of world economy to attract capital and modern technology.
- Liberalization of international trade related rules.
- Abolisation of branch licensing.

### 1.9.2 Banking Reforms

Banking sector reforms overall all sectors because of broad direction of Narsimham committee-I and Narsimham committee-II. Narsimham committee suggested monetary policy framework for competition with global economy.

- Banks separately determine his own interest rates.
- Improvement of accounting systems of bank.
- Abolisation of directed credit programmes.
- Re-equitation of liquidity ratio.
- Re-construction of banking systems.
- End of dual control.
- More freedom to bank.

### 1.9.3 Narsimham Committee-I Major Reforms

The recommendations of Narsimham committee were implemented by the Government as outlined below:

#### a) Phasing of reduction of statutory

Phased reduction of statutory preemption SLR was earlier reduced 25% for increment NOTLs over 30-09-94 and for earlier period to 31.5%. However, w.e.f. October 22, 1997, it was brought down to 25% on a uniform pattern. CRR was reduced to 14 % and then 13% in credit policy of April 96, 12% subsequently during July 96, 10% in two slabs while announcing credit policy in October, 96 and reduced to 8% by july,1999.
b) Interest rate on CRR balances
   As per the recommendation, interest on eligible cash balances is paid at 4%.

c) Phasing out of directed credit programme
   The Government did not accept the recommendation of the committee to reduce the level of priority sector lending from 40%. However, the priority sector definition was enlarged to include detain categories of advances which were hitherto not part of the priority sector.

d) Interest rates deregulation
   Banks are given freedom to have their own references rate known as prime lending rate, instead floor and ceiling rates and fix individual borrower’s interest rate within a band over PLR.

e) Capital adequacy norms
   Recommendation of the Narsimha committee on banking sector reforming, 1991 of the capital adequacy norms and as on 31st March 1997 only two bank, first UCO bank and second Indian bank were not able to achieve the norms of 8%33.

f) Tax treatment provisions
   The limit of admissible deductive was enhanced to 5% of the income and 10% average aggregate advances of rural branches.

g) Restructuring of the banks
   No progress in this respect was made except that on 4-09-1993, a loss making bank viz, New bank of India was merged with Punjab National banks.

1.9.4 Narsimham Committee-II (1998)34
   The Narsimham appointed a second time as a head of “committee on banking sector reforms” by the Government of India, to review the implementation of the reforms recommended by the earlier committee.
The Narsimham committee submitted his reports in April 1998 and made recommendation covering various aspects of banking policy.

1.9.5 Verma committee

Verma committee was appointed in 1999; he suggested some earlier steps to changes in banking sector which are as follow:

- Restriction on weak bank.
- Merger and acquisition of bank.
- Voluntary retirement schemes.
- Closure of subsidiary weak banks.

1.9.6 Khan committee

Earlier the Khan Committee was also appointed for some technical suggestions for banks. Khan Committee suggested some recommendations which are as follow:

- Universal Banking.
- Merger and acquisition of bank.
- Specific regulatory frame work.
- Multiple regulatory frame work.

1.9.7 Positive response of reforms

The RBI made progress in modifying the policy framework for reforms. After reforms, it is indicated that reforms make a positive effect on Indian economy. Let’s see the changes.

1. SLR, which was 37.4% in March 1992, came down to 25 % in 2001.
2. CRR, which was 15% in January 1992, was brought down to 5.5% in December 2001.
3. The bank rate was reduced from 12% in October 1991 to 6.5% in October 2001.

5). Capital adequacy ration of public sector bank was 23 out of 27. They had maintained ratio of 10% as the prescribed ratio being 9 % of 15 nationalized banks full into this category i.e. exceeding 10%.

6). The ratio of gross NPAs to gross advances which was 23% in 1992-93 declined to 12.4 % by march 2001. Net NPAs to net advance was 6.7% in 2001. Net profit of public sector bank amounted to Rs.2095cr in 2001 as against a net lose of Rs.4705cr in 1993-94.

1.10 **Fourth phase (Beyond 2002)**

Fourth phase of banking is now completely affected by technology aspects. Technology has made tremendous impact on the banking industry and bought about many changes.

Virtual E-banking and any ware and any time banking are the order of the day. The financial sector operates in a more competitive environment than before and intermediates huge volume of international financial flows in the wake greater financial deregulation and global financial integration. Indian banks face several challenges in the regard like:

- Financial infusion.
- Wealth management.
- Implementation of Basel-II norms.
- Deregulation of Indian banking scoter in 2009.
- Consolidation/ merger and acquisition.
- Customer relationship management (CRM).
- Cyber Security.
- Hectic competition and so on.
To meet these challenges effectively, the banks have to be optimistic in their approach. According to David Rockefeller, a permanent American banker, in his book Creative Management in Banking, explains the essence of creative banking has five characteristics:

- Flexibility of approach.
- Receptively to changes.
- Optimism.
- Courage to risk mistakes.
- Sense of social responsibility.

By keeping in mind all these respects, the banks must continuously monitor the trends in the economy and take care of the rising rupee. ICICI bank CEO K.V. Kamath has given the following message for the present day bankers.

The present day banking can be summarized in three words.

- Transformation.
- Technology.
- Transparency.

As per the “Indian banks association report industry vision 2010”, there will be more number of international players in the Indian financial system and some of the Indian banks may become global players in the coming years.

Fourth phase (beyond 2002) has been discussed under five parts namely:

1.10.1 New challenge encountered.
1.10.2 New dimensions focus.
1.10.3 Human resource management in banking sector.
1.10.4 Corporate governance.
1.10.5 KYC (Know your customers) norms.
1.10.1 New Challenge encountered

The first phase of financial reforms laid the basis for a sound banking system. Considerable progress has been made in implementing the reforms and the banking system is now moving towards the second phase. Nevertheless, the Indian Banking System faces several difficult challenges; therefore, the banks have re-oriented their strategies in the light of their own strengths and the kind of challenges⁴⁰.

1.10.2 New Dimension focus

Indian Banks will have to operate in a deregulated competitive financial sector. Competitive pressure is building up for Indian Banks both from within and from outside. Competition is likely to intensify in the coming years within the industry, from NBFCs and from foreign entities. Competition is not just in terms of number of competitors but in terms of proliferation of innovations, specialized markets cross border trade in financial services and capital flows. Our reforms have made progress but we have not become competitive internationally. We can not lag behind other countries and we have to transform the Indian Banking System from being a largely domestic one to a truly international one; and this should enable India to emerge as an international banking centre⁴¹.

The worldwide revolution in information and communication technology (ICT) has become the biggest force of change in banking. It is a source of productivity growth and facilitates effective competition. ICT reduces costs, increases volumes and facilitates customized products. It plays an important role in the payments and settlement system. Technology has opened up new avenues in banking for discharging the same functions in a cost effective manner like 24 hour banking, tele-banking, internet banking; E-banking etc. The process of technological
change is just beginning in Indian Banking. Even the use of existing technology is at low levels.

Though RBI and the banks have been taking steps in the last few years, computerization has been mostly directed towards accounting and related activities, without emphasis on critical areas relevant to management and customer service and customized products. The Indian Banking System will have to redouble its efforts to build the technological infrastructure not only to provide cost-effective and competitive customer service but also to achieve international recognition and status.

The level of non-performing assets (NPAs), though declining in recent years, continues to be high by international standards. NPAs have become a first charge on banks funds for provisioning and these affect banks performance by eating into their profitability. The most important condition for improvement in the profitability of banks is a reduction in the level of NPAs. In fact, it is a pre-condition for the stability of the banking system. The response to the efforts at debt recovery and restructuring of assets and other methods has been slow. The strategies for containing the problem of NPAs should emphasis the strict enforcement of prudential norms and requirements, transparency and disclosure and the need for legislation, which will make the recovery process smoother. Reforms have to be supported by legal changes for enforceability of contracts. In any effort to build a banking system of international stature, reduction in NPAs should be the priority target.

Asset-liability mismatches expose the banks to various types of risks i.e. risks of illiquidity and insolvency; risks arising from globalization and deregulation. Risk management is a continuous process of controlling assets and liabilities in terms of size, maturities and yields. As operations in the financial market become varied and complex, banks have to equip
themselves with a variety of skills and appropriate technology. The RBI has issued guidelines to banks in April 1999, for asset-liability management, which would help the bank management to meet the challenges. Banks are encouraged to prescribe risk parameters and establish effective control system. Now the action lies entirely with banks. The general complaint that customer satisfaction is at low levels needs to be addressed in all seriousness. The effort should be not only to preserve the existing circle of clients, both corporate and individual, but also to enlarge the client base. Banks need to develop customer relationship, which has come to be known as "Relationship Banking". It is concerned essentially with maintaining relations with customers on a continuing basis. The Customer Relationship Management (CRM), it is not just the relationship built around raising deposits and making loans, but CRM goes well beyond that, two important aspects of CRM that 1). It does not view customers in totality or in the aggregate and 2). The devising of banking products. Regarding the first, customers’ need and demands and business styles vary; and it is, necessary to consider segments of customers and build customer profiles to evolve strategies. As banking products are intangible, CRM involves personal selling. As per the second, once the need for segment approach is recognized, product differentiation becomes important. The present methods of evolving banking products and then looking around for customers for those products would not yield the desired results. In short, banking products should be customer based. Besides, the method of pricing products should also change from cost plus to product quality. To raise the level of customer satisfaction, banks will have to set up CRM groups or CRM departments.
1.10.3 Human resource management in banking sector

Human Resource Management is the function within an organization that focuses on recruitment, management and providing direction for the people who work in the organization.

Human Resource Management is the organizational function that deals with issues related to people such as compensation, hiring, performance management, organization development, safety, wellness, benefits, employee motivation, communication, administration, and training. Human Resource Development is the most important need for a service industry like banking. The banking industry being largely in the public sector, certain rigidities developed in HRD within the banking system. Apart from being the preferred employer for the educated manpower, public sector banks followed a hierarchical structure, which gives preference to seniority over performance. Besides, the banks continued, until recently, their generalist orientation in the matter of recruitment. In the result, the best talent especially specialist, could not be attracted. The approach to human resources management in banks will have to change in tune with the fast changing banking environment at home and abroad. While it is difficult to bring about radical changes in the staff structure in the near future, public sector banks can effect improvements in the existing practices of recruitment, training and redeployment. Information technology is an area where HRD is now critical. There is also the urgent need for training for up gradation of different types of skills, for redeployment, for changing the mindset and attitudes. It is time that banks develop their HRD departments and evolves appropriate policies to make the best use of their primary asset i.e. human resources.
1.10.4 Corporate Governance:

Corporate governance is about promoting corporate fairness, transparency and accountability. Corporate governance is the process, customer’s policies, laws and institution affecting the way a corporate or company is directed, administrated or controlled.

“Corporate governance is a system by which companies are directed and controlled.”

-Cadbury

“Corporate governance as the process by which corporations are made responsive to the rights and wishes of stakeholders”

-Demb Neubauer

Corporate governance is assuming greater importance in the banking sector today, as a result of certain unhealthy developments in recent years. The main focus in corporate governance is how to enhance shareholder value and this needs to be achieved in a legal and ethical manner leading to contribution to business prosperity. The major ingredients of good corporate governance would be accountability at all levels, transparency and enhancing the image of the organization in the eyes of the public. Corporate governance underlines the belief that the public goods should be placed above the private goods and that corporate resources cannot be used for personal benefit. Ethics is a part of good governance. Ethics apart, good governance is concerned with observing rules and regulations, guidelines and clean corporate practices. Public sector banks have to pay considerable attention to corporate governance in the context of deregulation, prudential norms, risk-based supervision and globalization. As part of the ongoing reforms, bank managements and their boards have been given greater autonomy. It is very important that greater vigilance over adherence to prescribed rules, norms and regulations is exercised. It is only then that autonomy for banks would be
meaningful. The response groups in the banking system are banks. RBI, the government and the customers; and the onus is on them to raise Indian banking to international standards.

1.10.5 KYC (Know Your Customer) norms

The objective of the KYC guidelines is to prevent banks from being used, intentionally or unintentionally, by criminal elements for money laundering activities. The revised KYC policy of the bank incorporates the following five elements:

i. Customer Acceptance Policy (CAP).
ii. Customer Identification Procedures (CIP).
iii. Monitoring of Transactions.
iv. Risk Management.
v. Customer education.

A customer for the purpose of KYC Policy is defined as:

- A person or entity that maintains an account and/or has a business relationship with the bank.
- One on whose behalf the account is maintained (i.e., the beneficial owner).
- Beneficiaries of transactions conducted by professional intermediaries, such as Stock Brokers, Chartered Accountants, Solicitors, etc as permitted under the law.
- Any person or entity connected with a financial transaction which can pose significant reputational or other risks to the bank, say, a wire transfer or issue of high value demand draft as a single transaction.

i. Customer Acceptance Policy (CAP)

The following Customer Acceptance Policy indicating the criteria for acceptance of customers shall be followed in the bank. The branches shall accept customer strictly in accordance with the said policy:
a. No account shall be opened in anonymous or fictitious/benami name(s).

b. Parameters of risk perception shall be clearly defined in terms of the nature of business activity, location of customer and his clients, mode of payments, volume of turnover, social and financial status etc., to enable categorization of customers into low, medium and high risk called Level I, Level II and Level III respectively; Customers requiring very high level of monitoring e.g., Politically Exposed Persons (PEPs) may be categorized as Level IV.

c. The branches shall collect documents and other information from the customer depending on perceived risk and keeping in mind the requirements of AML Act, 2002 and guidelines issued by RBI from time to time.

d. The branches shall close an existing account or shall not open a new account where it is unable to apply appropriate customer due diligence measures i.e., branch is unable to verify the identity and/or obtain documents required as per the risk categorization due to non co-operation of the customer or non reliability of data/information furnished to the branch.

e. Customer is permitted to act on behalf of another person/entity. The branches are advised to strictly follow these instructions.

f. The branches shall make necessary checks before opening a new account so as to ensure that the identity of the customer does not match with any person with known criminal background or with banned entities such as individual terrorists or terrorist organizations etc. RBI has been circulating lists of terrorist entities notified by the Government of India so that
banks exercise caution against any transaction detected with such entities.

The branches shall prepare a profile for each new customer based on risk categorization. The risk to the customer shall be assigned on the following basis:

- **Low Risk (Level I):**
  
  Individuals (other than high net worth) and entities whose identities and sources of wealth can be easily identified and transactions in whose accounts by and large conform to the known profile may be categorized as low risk. The illustrative examples of low risk customers could be salaried employees whose salary structures are well defined, people belonging to lower economic strata of the society whose accounts show small balances and low turnover.

- **Medium Risk (Level II):**
  
  Customers that are likely to pose a higher than average risk to the bank may be categorized as medium or high risk depending on customer’s background, nature and location of activity, country of origin, sources of funds and his client profile etc.

- **High Risk (Level III):**
  
  The branches may apply enhanced due diligence measures based on the risk assessment, thereby requiring intensive ‘due diligence’ for higher risk customers, especially those for whom the sources of funds are not clear. The examples of customers requiring higher due diligence may include:

  a) Non Resident Customers.
  b) High Net worth individuals.
  c) Trusts, charities, NGOs and organizations receiving donations.
  d) Companies having close family shareholding or beneficial ownership firms with ‘sleeping partners’.
e) Politically Exposed Persons (PEPs) of foreign origin.
f) Non-face to face customers.
g) Those with dubious reputation as per public information available.
h) The persons requiring very high level of monitoring may be categorized as Level IV.

ii. Customer Identification Procedure (CIP)

Customer identification means identifying the person and verifying his/her identity by using reliable, independent source documents, data or information. The branches need to obtain sufficient information necessary to establish, to their satisfaction, the identity of each new customer, whether regular or occasional, and the purpose of the intended nature of banking relationship. Being satisfied means that the branch is able to satisfy the competent authorities that due diligence was observed based on the risk profile of the customer in compliance of the extant guidelines in place. Besides risk perception, the nature of information/documents required would also depend on the type of customer (individual, corporate etc). For customers that are natural persons, the branches shall obtain sufficient identification data to verify the identity of the customer, his address/location, and also his recent photograph. For customers that are legal persons or entities, the branches shall (i) verify the legal status of the legal person/entity through proper and relevant documents (ii) verify that any person purporting to act on behalf of the legal person/entity is so authorized and identify and verify the identity of that person (iii) understand the ownership and control structure of the customer and determine who are the natural persons who ultimately control the legal person. Customer Identification require in respect of a few typical cases.
iii. Monitoring of Transactions

Continuous monitoring is an essential ingredient of effective KYC procedures and the extent of monitoring should be according to the risk sensitivity of the account. Branches shall pay special attention to all complex, unusually large transactions and all unusual patterns which have no apparent economic or visible lawful purpose. Transactions that involve large amount of cash inconsistent with the size of the balance maintained may indicate that the funds are being ‘washed’ through the account. High risk accounts shall be subjected to intensive monitoring.

iv. Risk Management

The bank’s KYC policies and procedures covers management oversight, systems and controls, segregation of duties, training and other related matters. For ensuring effective implementation of the bank’s KYC polices and procedures, the Branch Managers shall explicitly allocate responsibilities within the branch. The Branch Manager shall authorize the opening of all new accounts. However, in case of branches with business of Rs.50 crore or above, where there is usually another senior Officer next below the Branch Manager heading the Accounts Department may authorize the opening of new accounts\(^46\). The branches shall prepare risk profiles of all their existing and new customers and apply Anti Money Laundering measures keeping in view the risks involved in a transaction, account or banking/business relationship.

The General Manager, Planning & Accounts Department shall be empowered to prescribe threshold limits for a particular group of accounts and the branches shall pay particular attention to the transactions which exceed these limits. The stake hold limits shall be reviewed annually and changes, if any, conveyed to branches for monitoring.
v. **Customer Education**

Implementation of KYC procedures requires branches to demand certain information from the customers that may be of personal in nature or which have hitherto never been called for. This can sometimes lead to a lot of questioning by the customer for collecting such information. Therefore, the front desk staff needs to handle such situations tactfully while dealing with customers and educate the customer of the objectives of the KYC programme. The branches shall also be provided specific literature/pamphlets to educate customers in this regard.

**1.11 BASEL-II Accord**

Basel is a framework for calculating capital to risk weighted ratio (CRAR) through an amendment in 1996, market risk was incorporated in the weighting scheme of Basel-I along with credit risk. Basel is considered as one size fits all frameworks, which needed to be upgraded as each bank has its own way in measuring, managing and mitigating risk. The Basel-II is of risk management which not only includes credit risk but the market and operational risk as well. Banks are capable of applying risk sensitive methodologies through Basel-II norms.

On 26th June 1974, a number of banks had released Deutschmarks to Bank Herstatt in Frankfurt in exchange for dollar payments that were to be delivered in New York. Due to differences in time zones, there was a lag in dollar payments to counter-party banks during which Bank Herstatt was liquidated by German regulators, i.e. before the dollar, payment could be affected.

The Herstatt accident prompted the G-10 countries (the G-10 is today 13 countries: Belgium, Canada, France, Germany, Italy, Japan, Luxembourg, Netherlands, Spain, Sweden, Switzerland, United Kingdom and United States) to form, towards the end of 1974, the Basel Committee
on Banking Supervision (BCBS), under the auspices of the Bank for International Settlements (BIS), comprising of Central Bank Governors from the participating countries.

The committee uses this common understanding to develop guidelines and supervisory standards in areas where they are considered desirable in this regard, the committee is best known for its international standards on capital adequacy, the core principle for effective banking supervision and the concordat on cross border banking supervision.

The present chairman of the committee is Mr. Nout Wellink, president of the Netherlands bank and Mr. Stefen Walter is the secretary general of the Basel Committee.

The BCBS has been instrument in standardizing bank regulations across jurisdiction with special emphasis on defining the roles of regulations in cross jurisdictional situations. The committee meets fours times a year. It has around 30 technical working groups and task forces that meet regularly.

Basel-II accord has been discussed under five groups namely:

1.11.1 Basel committee working groups.
1.11.2 The Basel-II recommended three approaches.
1.11.3 Structure of the Basel-II accord.
1.11.4 The new Basel norms on capital adequacy.
1.11.5 The salient features of the capital accord.
1.11.1 Basel Committee Working Groups

1). The Standards Implementation Group (SIG)

SIG was originally established to share information and promotes consistency in implementation of the BASEL-II framework in January 2009; its mandate was broadened to concentrate on implementation of Basel committee guidance and standards more generally. It is chaired by Mr. Jose Maria Roldan, Director General of Banking Regulation at the Branch of Spain. Currently the SIG has two subgroups that share information and discuss specific issues related to Basel-II implementation.

2). The Policy Development Group (PDG)

PDG is to support the committee by identifying and reviewing emerging supervisory issues and, where appropriate, proposing and developing policies that promotes a sound banking system and high supervisory standards. The group is chaired by Mr. Stefan Walter, secretary General of the Basel committee.

3). The Accounting Task Force (ATF)

ATF works to help ensure that international accounting and auditing standards and practices promote sound risk management at financial institutions, support marked discipline through transparency and reinforce the safety and soundness of the banking system to fulfill this mission, the task force develops prudential reporting guidance and takes an active role in the development of international accounting and auditing standards. Ms. Sylvie Matherat, Director of financial stability, Bank of France, chairs the ATF.

1.11.2 The Basel-II recommended three approaches.

The new framework maintains capital requirements 8% of capital to risk-weighted assets. The new record has elaborated the credit risk
measurement methods and emphasized the measurement of operational risk. The Basel-II has recommended three approaches.

1) The standardized approach.
2) The foundation internet risk based approach.
3) The advanced internal risk based approach.

**Evolution of Basel Committee**

1). **Settlement risk**
   - 1974 Cross border regulation

2). **Credit risk**
   - 1988 Capital adequacy

3). **Market risk**
   - 1996 Internal models

4). **Operational risk**
   - 2004 Market discipline economic capital

Above diagram show that basel committee has changed rules and regulation in various needs of market discipline. Evolution of Basel committee depends on various risk seen in market position then after necessary change accepted by Basel committee in his accords.

**1.11.3 Structure of the BASEL-II accord**

This accord is based on three mutually reinforcing pillars, which together contribute to the safety of the financial system.
### Table: 1.4

An overview of the BASEL-II ACCORD

<table>
<thead>
<tr>
<th>Pillar-1 Minimum capital requirement</th>
<th>Pillar-2 Supervisory</th>
<th>Pillar-3 Market</th>
</tr>
</thead>
<tbody>
<tr>
<td>1. Capital for credit risk</td>
<td>1. Evolution risk</td>
<td>1. Enhance disclosure</td>
</tr>
<tr>
<td>- Standardized approach</td>
<td>assessment</td>
<td>2. Core disclosure and</td>
</tr>
<tr>
<td>- International rating based</td>
<td></td>
<td>supplementary</td>
</tr>
<tr>
<td>advanced</td>
<td></td>
<td>disclosure.</td>
</tr>
<tr>
<td> Foundation</td>
<td>2. Ensure soundness</td>
<td>3. Semi annully</td>
</tr>
<tr>
<td> Approach</td>
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<td>2. Capital of market risk</td>
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<td>- Standardized method</td>
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Source: - Indian banking in the globalised world, R.K. Upppal, P.3, pub: New Centaury publication, New Delhi, June-2008

### 1.11.4 The New Basel Norms on Capital Adequacy

The Basel committee on banking supervision (BCBS) brought out his consultative paper on new capital adequacy framework in June, 1999 and a second revision on January, 2001 after an informed public debate. The new rules will be effective from 2005. The new Basel capital accord
based on three mutually reinforcing pillars that allow banks and supervisions to evaluate properly the various risks that the banks face.

1). **Minimum capital requirements**

The new framework maintains both the current definition of capital and the minimum requirement of 8% of capital to risk weighted assets. The revised accord will be extended on a consolidation basis to holding companies of banking groups. The accord stresses upon the improvement in the measurement of risks.

**Formula:-**

\[
\text{Capital ratio} = \frac{\text{Total capital}}{(\text{Minimum} \, 8\%) \cdot (\text{Credit risk} + \text{Market risk} + \text{Operational risk})}
\]

The Basel committee recommended that from the end of 1997 or earlier banks are required to measure and apply capital cheques in respect of their market risks in addition to their credit risks. Banks in G-10 counties have already incorporate Tier-3 capital into their norms for capital adequacy.

Thus, besides the earlier Tier-1 and Tier-2 capital, a new category of capital, Tier-3 has been created. As such, eligible to cover market risks includes equally and retained earning (Tier-1), supplementary capital (Tier-2), and a third Tier of capital (Tier-3) in order to qualify as Tier-3 capital.
2). **Supervisory review process:-**

This process emphasis the need for banks to develop sound internal processes to access the adequacy of capital based on a through evaluation of its risks and set commensurate targets for capital. The internal processes would then be subjected to supervisory review and intervention.

3). **Market discipline:-**

Market discipline can be through enhanced disclosure by banks. The new framework sets out disclosure requirement in several areas, including the any in which banks calculate their capital adequacy and their risk assessment methods. The underlying idea of the market discipline pillar of the accord is to enable the user to assess whether the available is sufficient to meet credit risk and market risk and other risk requirements.

In recent years, it has been observed that government in developing countries, with few exceptions have not set national capital standard much above the BASEL minimum norm and their banks have not held actual much above that for banks in countries with significantly more stable operating environments.

1.11.5 **The salient features of the capital accord**

The committee on banking regulations and supervisory practices held in July, 1988 released the agreed framework on international convergence of capital measures and capital standard. The committee adopted risk assets approaches, its salient features are given below:

- Minimum capital requirement for banks is linked by formula to credit risk as determined by the composition of their assets, the greater credit risk, the higher regulatory capital required.
- The minimum capital to risk weighted assets ratio (CRAR) is set at 8%.
It defined capital in two tiers, Tier-1 and Tier-2. Tier-1 capital representing the most permanent should be at least 4% of the risk weighted assets and the Tier-2 capital which is less permanent in nature will be limited to 100% of Tier-1 capital.

The regulatory capital requirements are standardized between countries to level of playing field so that the banks in one country may not have competitive advantages over banks in other countries due to divergent capital adequacy across the countries.

A four step process is to be followed by big banks for computing the CRAR.

a. Classify on balance sheet assets into one of four risk categories.

b. Convert off balance sheet exposures into credit equivalent amounts using the prescribed multipliers and then classify the converted amount into appropriate risk categories.

c. Multiply the amount of assets in each risk category by the appropriate risk weight to arrive at risk weighted assets.

d. Divide the total capital or Tier-1 capital by the risk weighted assets to arrive at CRAR and core CRAR respectively.

1.12 **Types of Bank**

The major types of the Indian banking system are given below:

1.12.1 Reserve bank of India.

1.12.2 The scheduled commercial bank.

1.12.3 The non-scheduled bank.

1.12.4 Public sector bank.

1.12.5 New private sector bank.

1.12.6 Regional rural bank.
1.12.7 Co-operative bank.

**Diagram :**-1.1

**Types of banks**

![Diagram showing types of banks](image)

Source: RBI trend and progress reports of banking in India, RBI of India, Second scheduled of the RBI act, 1934, various issues, types of bank  

**1.12.1 Reserve Bank of India**

The reserve bank of India acts as central bank of India. It was established on April 1, 1935 in accordance with the provisions of the RBI Act, 1934. RBI is the supreme monetary and banking authority in the country and responsible for controlling banking system in India. The preamble of the Reserve bank of India describes the basic function of reserve bank as

“…to regulate the issue of bank notes and keeping of reserves with a view to securing monetary stability in India and generally to operate the currency and credit system of the country to its advantage”

-RBI Act
The Hilton young commission recommended that of central bank in country is necessary, the Government has passed RBI act, 1934 and established RBI. Reserve bank of India mainly looks after the following important functions:

- Control over the banking evaluation of central and state government.
- Control over creation of credits and currency supply.
- Control over foreign currency transaction.
- Central administered authority of all other banks in the country.
- Audits of all Indian banks.
- Approval capital reserve and liquid assets of banks.
- Control over the amalgamation and liquidation.
- Credit information services.

1.12.2 The Scheduled commercial bank

Scheduled Banks in India constitute those banks which have been included in the Second Schedule of Reserve Bank of India (RBI) Act, 1934. RBI in turn includes only those banks in this schedule which satisfy the criteria laid down vide section 42 (6) (a) of the Act. Scheduled banks in India means the State Bank of India constituted under the State Bank of India Act, 1955 (23 of 1955), a subsidiary bank as defined in the State Bank of India (Subsidiary Banks) Act, 1959 (38 of 1959), a corresponding new bank constituted under section 3 of the Banking Companies (Acquisition and Transfer of Undertakings) Act, 1970 (5 of 1970), or under section 3 of the Banking Companies (Acquisition and Transfer of Undertakings) Act, 1980 (40 of 1980), or any other bank being a bank included in the Second Schedule to the Reserve Bank of India Act, 1934 (2 of 1934), but does not include a co-operative bank.57
1.12.3 The Non-scheduled commercial bank

The Non-scheduled commercial banks are those which have not been included in the second scheduled of RBI Act, 1934 at present these are only three non-scheduled commercial banks in the country. “Non-scheduled bank in India” means a banking company as defined in clause (c) of section 5 of the Banking Regulation Act, 1949 (10 of 1949), which is not a scheduled bank”\textsuperscript{58}.

1.12.4 Public sector banks

Public sector banks are those which have stake holding by government of India, they are classified into two groups:

1.12.4.1 State bank of Indian group.
1.12.4.2 Nationalized bank.

1.12.4.1 State bank of Indian group

The state bank of India was established under the state bank of India Act 1955, the subsidiary banks under the state bank of India establishing banks Act 1959, the reserve bank of India owns the state bank of India, to a large extent and rest of the part is some private ownership in the share capital of SBI\textsuperscript{59}.

List of SBIs 7 subsidiaries associates banks:
1. State Bank of Bikaner and Jaipur.
5. State Bank of Patiala.
7. State Bank of Travancore.
1.12.4.2 Nationalized bank

Nationalized banks dominate the banking system in India. The history of nationalized banks in India dates back to mid-20th century, when Imperial Bank of India was nationalised under the SBI Act of 1955 and re-characterized as State Bank of India in July 1955. Then on 19th July 1960, its seven subsidiaries were also nationalized with deposits over 200 crores. These subsidiaries of SBI were State Bank of Bikaner and Jaipur (SBBJ), State Bank of Hyderabad (SBH), State Bank of Indore (SBIR), State Bank of Mysore (SBM), State Bank of Patiala (SBP), State Bank of Saurashtra (SBS), and State Bank of Travancore (SBT).

However, the major nationalization of banks happened in 1969 by the then-Prime Minister Indira Gandhi. The major objective behind nationalization was to spread banking infrastructure in rural areas and make cheap finance available to Indian farmers. The nationalized 19 major commercial banks were Allahabad Bank, Andhra Bank, Bank of Baroda, Bank of India, Bank of Maharashtra, Canara Bank, Central Bank of India, Corporation Bank, Dena Bank, Indian Bank, Indian Overseas Bank, Oriental Bank of Commerce (OBC), Punjab and Sind Bank, Punjab National Bank (PNB), Syndicate Bank, UCO Bank, Union Bank of India, United Bank of India (UBI), and Vijaya Bank.

In the year 1980, the second phase of nationalization of Indian banks took place, in which 7 more banks were nationalized with deposits over 200 crores. With this, the Government of India held a control over 91% of the banking industry in India. After the nationalization of banks, there was a huge jump in the deposits and advances with the banks. At present, the State Bank of India is the largest commercial bank of India and is ranked one of the top five banks worldwide. It serves 90 million customers through a network of 9,000 branches.
List of Public Sector Banks in India is as follows:

1. Allahabad Bank.
4. Bank of India.
5. Bank of Maharashtra.
7. Central Bank of India.
10. Indian Bank.
11. Indian Overseas Bank.
17. State Bank of India (SBI).
22. State Bank of Travancore.
24. UCO Bank.
25. Union Bank of India.
26. United Bank of India.
27. Vijaya Bank.
28. IDBI Bank.
1.12.5 New private sector bank

These banks lead the market of Indian banking business in very short period because of variety of services and approach to handle customer. Private sector bank came into existence after the recommendation of Narsimham committee-I in 1992. Private sector bank is also registered under the company Act, 1956.

List of private sector bank:

1. AXIS Bank Ltd.
2. Capital Local Area Bank Ltd.
3. City Union Bank Ltd.
4. Coastal Local Area Bank Ltd.
5. Development Credit Bank Ltd.
7. ICICI Bank Limited.
8. IndusIand Bank Limited.
9. ING Vysya Bank Ltd.
10. Karnataka Bank Ltd.
13. SBI Commercial and International Bank Ltd.
14. Tamilnad Mercantile Bank Ltd.
15. The Bank of Rajasthan Limited.
16. The Catholic Syrian Bank Ltd.
17. The Federal Bank Ltd.
18. The HDFC Bank Ltd.
19. The Jammu & Kashmir Bank Ltd.
20. The Karur Vysya Bank Ltd.
21. The Lakshmi Vilas Bank Ltd.
22. The Nainital Bank Ltd.
23. The Ratnakar Bank Ltd.
24. The South Indian Bank Ltd.

### 1.12.6 Regional rural bank

The regional rural bank in first instance was made up by Saraiya commission. Saraiya commission submitted his report in 1972 and the government of India announced in July 1975. Government had decided to step up 50 regional rural banks in different parts of the country in the next two years and there were 196 regional rural banks at the end of March 2006 with their 14494 branches over the India. The necessity of rural banks was felt because the existing credit agencies, the co-operative banks and the commercial banks lacked in certain respects in meeting the needs of the rural areas\(^61\).

.hourglass Capital resources of RRB

- 50% by the central bank.
- 35% by the sponsoring commercial banks.
- 15% by the state government concerned.

.hourglass Objective

The main objective of these banks is to provide productive credit to the weaker section of the rural areas so as to enable them to increase their productivity and income.

### 1.12.7 Co-operative bank

Co-operative bank came into existence with the enactment of the co-operative credit society’s Act of 1904, which provided for the formation of co-operative credit societies\(^62\).

Co-operative bank has been divided into two parts namely:

1.12.7.1 State co-operative banks (SCB).

1.12.7.2 Central co-operative bank (CCB).
1.12.7.1 State co-operative banks (SCB)

State co-operative banks are the top of the co-operative pyramid in India. SCB serves as a connecting link between NABARD and central co-operative banks at the district level along with the primary credit societies Act the village level. At the end of 31st March 2001, there were 29 SCBs in India and they had advanced annually about 38250 crores to central co-operative banks and primary co-operative credit societies\(^{63}\).

1.12.7.2 Central co-operative bank (CCB)

Central co-operative bank (CCB) works at the district level. It is provided finance to primary credit societies for their activities. It is a federation of such societies. In the specific area or district, it functions as a link between state co-operative banks. At the end of the March 2001, there were 367 CCBs in India with outstanding loan of Rs. 47630 crores\(^{64}\).

1.13 **Function of modern Bank**

Every bank has to perform certain functions, through borrowing and lending money. Function of bank may be broadly classified into four categories as given below:

1.13.1 Primary function.
1.13.2 Demand deposit.
1.13.3 Time deposits.
1.13.4 Accepting of deposits.

1.13.1 Primary function

Those functions on which a bank’s viability and existence depend are called primary function. The primary function of a banks are deposits and lending, investing fund so accepted are defined in section (1) (B) of the banking Regulation act. 1949 Section 6(1) (A) of this act specifies other forms of business which essential for a banking company. Accordingly no banking company can obtain a licensee from the Reserve
bank, under section 22, of the same act, unless it undertakes to carry on the business in India as defined in the Act. Deposits forms the liabilities side of a bank’s balance sheet, these products offer products and services across all segments of a bank’s customer base line individual customers, professionals, self employed individuals or small and medium business enterprise, large corporate houses, trusts, consultant and non-residents Indians. The focus is on creating products and services that meet the needs of targets customers and meet their liquidity needs whilst being profitable for the bank as well.

Deposits products are offered by bank to fund the assets side of the balance sheet. Interest rates vary from time to time based on the assets – liability balance that the bank wishes to maintain. The approach to deposit products is entirely based on the specific liquidity position that the bank requires and time horizons to meet various obligations from time to time.

Undertaking deposit products will serves customers better as it would give a perfect and insight in to how such products are structured and specific requirement for each set of products. This would help in advising customers in a more informed manner.

1.13.2 Demand deposits

Demand deposits are those that can be withdrawn or transferred by the customers without previous notice to the bank. The deposits are maintained to meet liquidity and transaction need. Demand deposits are two i.e. current deposits and saving deposits.

1.13.3 Time deposits

Time deposits are also called fixed deposits or term deposits. Theses are repayable after the expiry of a specified period varying from 15 days to 120 months.
1.13.4 Accepting of deposits

The oldest and the most important function of commercial banks is to accept deposit. It is primary function of a commercial bank. The Jews and goldsmiths had started banking by accepting deposits. Even today all the banks accepts deposits of money from the public. These deposits may be repayable on demand or on the expiry of a fixed period. Deposits are accepted on various types of accounts, namely, current account, saving bank account, home safe account and fixed deposits account. Bankers pay interest on such deposits. The longer is the period of deposits; the grater is the rate of interest.

1.14 Conclusion

In the last few years, the Indian banking system has improved in profitability, productivity, assets quality and capital adequacy. Public sector banks are facing stiff competition from the private sector banks. Banks will require a large amount of funds and personnel expertise to manage risk. Banks will be required to put in place system for internal controls and risk management. Bank should focus on core competence and collaborate with other bank to offer innovative products and monitoring customer service. The function of banking is no longer acceptance of deposits for lending. Today, banking activities refers as an intermediation. The Government of India set up the Narsimham Committee to examine all respects relating to structure, organisation and functioning of the Indian banking system. The recommendations of the committee aimed at creating a competitive and efficient banking system. Measures like capital adequacy, income recognition, asset classification, norms for investment, entry of private sector banks, gradual reduction of SLR and CRR were recommended and implemented to strengthen the banking system.
From the above discussion, it is vivid that to have a cohesive and strong financial system capable and responding to the changed economy, it becomes important to have a dynamic, autonomous and profitable financial system. At present, Indian banking system needs a fresh outlook and keeping in mind the various distortions, government should introduce third banking sector reforms. Indian banking sector industry also should learn many lessons from the global financial crisis.
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