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Roll No. ....

OPEN BOOK EXAMINATION

Time allowed : 3 hours ***Maximum marks : 100***

Total number of questions : 6 ***Total number of printed pages : 8***

NOTE : *Answer* ***ALL*** *Questions.*

1. Read the following case study and answer the questions that follow :

Non-Banking Financial Companies (NBFCs)

The Non-Banking Finance Companies (NBFCs) ecosystem in our country is a place of immense diversity and complexity as well. There are more than 9,000 NBFCs across different categories focussed on a diverse set of products, customer segments, and geographies. As of March 3l, 2021, the NBFC sector (including HFCs) has assets worth more than ₹ 54 lakh crore, equivalent to about 25% of the asset size of the banking sector. Therefore, there can be no doubt regarding its significance and role within the financial system in meeting the credit needs of a large segment of society. Over the last five years the assets of the NBFC sector have grown at a cumulative average growth rate of 17.91 percent. Demand-side pull or supply-side push which is contributing to the growth of the NBFC sector.

This distinction becomes important as it has significant implications for the efficiency of the sector. Conventional wisdom tells that growth consequential to demand-side pull factors translates into increased efficiency and better services to the customers. Supply-driven growth could, on the other hand, arise out of entry by entrepreneurs who would like to enter financial services industries but are unable to meet the scale and stringent norms meant for banks.

The preamble to the Reserve Bank of India Act, 1934, enjoins on the Bank, to operate the currency and the credit system of the country to its advantage. Thus, the promotion of an efficient financial intermediation system, which facilitates adequate credit flow to every segment of the society, more so to the financially disadvantaged population is an embedded goal for the Reserve Bank.

The non-banking financial sector assumes an important role in the process as it is a valuable source of financing for many firms, micro, and small units as well as individuals and small business, facilitating competition and diversity among credit providers. Further, niche NFBCs fulfill the unmet and exclusive credit needs of various segments such as infrastructure, factoring, leasing, etc. NBFC-MFIs reach out to the underprivileged sections of society. Along with banking, which is the primary channel of financial intermediation, NBFCs have been increasingly playing a significant complementary role in financial intermediation and provision of last-mile delivery of financial services.

Non-banking financial entities, by their regulatory design, enjoy the freedom to undertake a wider spectrum of activities as compared to banks for which the permissible activities are enshrined in the statute itself. This freedom, coupled with a light touch regulatory prescription, gives them a greater risk-taking capacity to engage in financial intermediation in the segments which are often underserved by other players. Hence, even with large universal banking's reach across the country, the NBFC sector can create a space for itself with customized services with a local feel.

Apart from furthering the financial inclusion agenda, the added advantage of a well-functioning NBFC sector is that it can promote resilience in the financial system by being innovative and agile in offering tailored financial products and solutions as a supplemental source of credit alongside banks. It has to be noted that many recent financial sector credit delivery innovations, for example, micro-credit, were popularised by non-banking financial entities. This capability and freedom to innovate spurs a competitive advantage in the financial services sector with the ultimate beneficiary in the process being the customer.

However, the reputation of the non-banking financial sector has been dented in recent times by the failure of certain entities due to idiosyncratic factors. The challenge, therefore, is to restore trust in the sector by ensuring that few entities or activities do not generate vulnerabilities that go undetected and create shocks and give rise to systemic risk through their interlinkages with the financial system. Forestalling and where necessary, decisively resolving such episodes becomes a key focus of our regulatory and supervisory efforts.

The Global monitoring report on Non-banking Financial Institution (NBFI) by Financial Stability Board (FSB) classifies non-banking financial activities into five economic functions. (i) collective investment vehicles, (ii) loan companies which depend on short-term funding, (iii) market intermediaries, (iv) entities which engage in the facilitation of credit creation (such as credit insurance companies, financial guarantors) and (v) entities undertaking securitization-based credit intermediation. Globally, the collective investment vehicles are the most dominant category of non-banking financial activity and account for 73 percent of the global NBFI sector. In the global context, the second function of NBFIs i.e., loan companies depending on short-term funding is a small segment constituting just around 7 percent of the total NBFI sector, but in India, the non-banking sector is largely into direct credit intermediation.

The regulatory challenge in India is thus different with the focus on designing prudential regulations specifically meant for lending activities of NBFCs without compromising on their operational flexibility.

Over the years, the NBFC sector has evolved in terms of its size, operations, technological sophistication with entry into newer areas of financial services and products. To keep pace with the same, regulations have also evolved to address various accompanying risks and concerns. Reserve Bank had introduced an element of the differential regulation way back in 2006 when the regulatory framework for systematically important NBFCs was strengthened. Further in 2014, a revised regulatory framework was announced and many of the regulatory parameters with regard to net owned fund, prudential requirements, and corporate governance standards were strengthened.

The regulatory framerwork for NBFCs has remained a work in progress and it continues to be so. The fundamental premise has, however, been to allow operational flexibility to NBFCs and help them grow and develop expertise.

Based on the above information, answer the following questions :

(*a*) What is a Non-Banking Financial Company (NBFC) ? (*4 marks*)

(*b*) How does NBFCs differ from Banks ? (*4 marks*)

(*c*) Is it necessary that every NBFC should be registered with RBI ? (*4 marks*)

(*d*) Why are certain NBFCs classified as systemically important NBFCs ? (*4 marks*)

(*e*) Give an example of Harmonisation of different categories of NBFCs. (*4 marks*) (*f*) How are Core Investment Companies (CICs) different from other NBFCs in terms of regulations ? (*4 marks*)

(*g*) What action can be taken against persons/financial companies making a false claim of being regulated by the Reserve Bank ? (*4 marks*)

(*h*) Explain the terms 'owned fund' and 'net owned fund' about NBFCs. (*4 marks*)

(*i*) NBFCs are charging high-interest rates from their borrowers. Is there any ceiling on the interest rate charged by the NBFCs to their borrowers ? (*4 marks*)

(*j*) Whether NBFCs can accept deposits from NRIs ? (*4 marks*)

2. Answer briefly the following questions :

(*a*) What is non-fund based financing of banks ?

(*b*) Why are the Nostro accounts maintained by banks ?

(*c*) Which Committees of the Bank Boards are constituted with focus on strengthening governance standards in banks ?

(*d*) Which three schemes are integrated into Reserve Bank Integrated Ombudsman Scheme, 2021 ?

(*e*) A voucher is essentially the backup document/proof for a transaction. How is it important for banking transactions ?

(*f*) What is the concept of 'Legal Entity Identifier' for Large Value Transactions in Centralised Payment Systems ?

(*2 marks each*)

3. (*a*) While discounting "Trade Bills" by the Banks, the Quality of such bills is to be checked. Explain the various factors to determine the Quality of Trade Bills.

(*3 marks*)

(*b*) How the 'acknowledgement of debt by borrower' helps banks in enforcing money suits while the document is Time-barred ? (*3 marks*)

(*c*) Read the following statements carefully. State whether True/False with reasons :

(*i*) Business Correspondent (BCs) model is useful for financial inclusion.

(*ii*) In case the banker refuses payment wrongfully, then he is liable only to the drawer of the cheque and not to any endorsee or holder.

(*iii*) Cyber Crime includes all unauthorized access of information and breaks of security like privacy, password, etc., with the use of the internet.

(*iv*) Securities and Exchange Board of India has created a Central Repository of Information on Large Credits.

(*v*) A bank cannot grant any loans and advances on the security of its own shares.

(*vi*) SMA stands for 'Standard Mention Account'.

(*1 mark each*)

4. (*a*) An Exporter in India wishes to Discount Trade Bill of SGD of 10,000.

Interbank transaction, India spot rate : USD 1 \$ = 74.10/20 Rupees and Forward rate at the time of contract.

1 Month	0.15/0.10
2 Months	0.25/0.20
3 Months	0.45/0.30

Buy transaction : Forward rates **USD VS INR**. Interbank rate, consider margin, In India, we buy dollars and send rupees (Buying rate).

Singapore spot rate : USD 1 \$ = 1.35/36 SGD and Forward rate at the time of contract.

1 Month	0.03/04
2 Months	0.04/05
3 Months	0.05/06

Sell Transaction : Forward rates **USD VS SGD**, in Singapore we sell the dollar and take SGD (Selling Rate).

The Exchange Margin is 0.15%.

The interest rate is 5%.

The transit period is 25 days.

The rate of interest is 8%.

What is the amount credited in Indian rupees to the exporters' current account ?

(*6 marks*)

(*b*) Consider a ₹ 1,000 par value bond, whose current market price is ₹ 850/-. The bond carries a coupon rate of 8 percent and has a maturity period of nine years. What would be the rate of return that an investor earns if he purchases the bond and holds it until maturity ? (*6 marks*)

5. (*a*) In what forms the credit risk arises for banks ?

(*b*) Why is there increasing importance of credit risk modelling ?

(*c*) In the measurement of Credit Risk, models may be classified into three different dimensions. What are such dimensions ?

(*4 marks each*)

6. (*a*) CTS brings elegance to the entire activity of cheque processing and clearing. How ?

(*b*) What is the Positive Pay System for large value cheques ? State briefly the procedure for its functioning.

(*c*) Non-Performing Assets (NPAs) have made the banks financially ill. Comment.

(*4 marks each*)

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