

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. Liquidity Adjustment Facility

Liquidity Management is a key function of the Reserve Bank of India (RBI) that ensures effective Monetary Policy transmission and smooth financial system operations. It involves the Central Bank's procedures to align short-term interest rates with the policy rate. The RBI's liquidity management framework involves three key aspects ;

- The operating framework,
- Liquidity drivers, and
- Liquidity control mechanisms.

The RBI's liquidity management framework has evolved through progressive refinements since 1999 in response to changing domestic and global conditions. Since 2011, the fixed overnight Repo (repurchase) Rate under the Liquidity Adjustment Facility (LAF) has been formally announced as the single Monetary Policy Rate, with the Weighted Average Call Money Rate (WACR) as the operating target of Monetary Policy. The effectiveness of Liquidity Management Operations depends on being predictive in assessing Liquidity and Market conditions and deploying instruments productively, singly and/or in combinations. The Liquidity Management framework was modified in April 2016, assuring both durable and frictional liquidity, while aiming to progressively lower the average ex-ante liquidity deficit in the system to a position closer to neutrality.

Efficient Liquidity Management is critical to Monetary Policy Operations. Even though liquidity management has short-term effects in financial markets, its implications are enduring in terms of its impact on Consumption, Investment and Capital formation in the economy. It has the following benefits to the economy.

- Supporting Economic Growth : By maintaining optimal liquidity, Banks can continue lending to businesses and consumers, supporting economic activity and growth in India.
- Facilitating Monetary Policy transmission : Effective liquidity management by the RBI helps in the smooth transmission of Monetary Policy to the broader economy.
- Ensuring Financial Stability : Effective Liquidity Management helps Indian Banks and financial institutions maintain adequate Cash Reserves and liquid assets to meet short-term obligations and withstand economic shocks.
- Meeting Regulatory Requirements : The RBI has implemented stringent liquidity requirements such as the Liquidity Coverage Ratio (LCR) for Banks. Proper Liquidity Management is essential for Banks to comply with these Regulatory Norms.
- Managing Volatility : Sound Liquidity Management helps Banks and the RBI handle sudden inflows or outflows of Foreign Capital.
- Mitigating Systemic Risk : Robust Liquidity Management Practices reduce the risk of contagion, as the liquidity shortages at major banks can quickly spread through the financial system.
- Building Investor and Depositor Confidence : Strong Liquidity Positions enhance the credibility of Banks among Investors and Depositors, crucial for maintaining stability.
- Managing Currency Fluctuations : Liquidity Management helps Banks handle Exchange Rate Volatility, which is important, given India's increasing Global Financial Integration.

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Key Drivers of Liquidity in the Banking System :

- Government Cash Balances with RBI : The Government's higher Cash holdings at the RBI reduce system Liquidity and lower cash holdings increase liquidity.
- Changes in Currency in Circulation : An increase in currency in circulation reduces liquidity in the Banking System, while a decrease in currency in circulation increases liquidity.
- RBI's Forex Operations : When the RBI buys foreign currency, it injects rupee liquidity into the system, and when it sells foreign currency, it absorbs rupee liquidity.
- RBI's Market Operations : Through its liquidity tools such as Open Market Operations (OMOs), the RBI can inject liquidity by purchasing government securities or absorb liquidity by selling them.
- Changes in CRR, SLR : An increase in Cash Reserve Ratio (CRR) or Statutory Liquidity Ratio (SLR) requirements reduces liquidity in the banking system, while a decrease increases liquidity.

Key Factors Affecting Surplus Liquidity :

- Credit and Deposit Mismatch : When there is an increase in bank deposits compared to the demand for credit, it creates a liquidity surplus in banks.
- Government Spending : Higher Government spending at the end of the month (salaries, pensions) can contribute to surplus liquidity.
- Redemption of Government Bonds : When government bonds mature and are redeemed, it adds to the surplus liquidity in the banking system.
- Withdrawal of High Denomination Currency Notes : Deposit of withdrawn currency notes contributes to increased surplus liquidity.
- RBI Intervention in Forex Markets : The RBI buying dollars to weaken the rupee, can increase rupee liquidity.

Key Factors Leading to Liquidity Tightness :

- High Demand for Bank Credit : If credit growth surpasses deposit growth, it can cause fund constraints and liquidity tightness.
- Advance Tax Payments by Corporates : Quarterly advance tax outflows can aggravate liquidity tightness.
- RBI Intervention in Forex Markets : The RBI selling dollars to defend the rupee can reduce rupee liquidity.

Banks try to borrow their shortfall of reserves from the interbank market. If reserve requirements such as CRR and SLR cannot be met in the interbank market, then banks borrow funds from the RBI under LAF. If banks are net borrowers under LAF, the system liquidity can be said to be in deficit. Conversely, if banks deposit more than the reserve requirement, then they become a net lender to RBI, and the system liquidity can be said to be in surplus. The RBI uses various tools to manage liquidity in the banking system, which is in line with its monetary policy stance. The RBI's main challenge is to ensure that changes in its policy instruments quickly and effectively influence its target interest rates. To achieve this, the RBI typically adjusts its liquidity operations in the following ways :

- Injecting funds into the system when needed, especially during periods of liquidity shortage.
- Timing government borrowing strategically to smooth out cash flows and prevent sudden liquidity crunches.
- Encouraging banks to rely more on borrowing from each other (the interbank market) rather than depending heavily on the RBI for their daily liquidity needs.

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Liquidity management is an important function of the RBI that ensures the smooth functioning of the financial system and the effective transmission of monetary policy. The RBI's liquidity management framework has evolved to address changing economic conditions and challenges and the RBI employs various direct tools such as CRR, SLR, or indirect tools through LAF to regulate the money supply and manage the Indian economy as and when required. As the Indian Economy continues to grow and integrate with Global Markets, effective liquidity management will remain crucial for maintaining financial stability and supporting economic growth. The RBI's ability to adapt its liquidity management tools and strategies to address emerging challenges, such as shifts in customer preferences and technological disruptions, will be key to ensuring the continued effectiveness of its Monetary Policy implementation.

With this background, answer the following questions :

- (a) What is Liquidity Adjustment Facility (LAF) and whether Re-repo in Government Securities Market is allowed ?
- (b) Who are the major players in the Government Securities (G-Secs) market ?
- (c) How and in what form can G-Secs be held ?
- (d) What is meant by Repo Market and Repurchase (buyback) of G-Secs ?
- (e) What are Open Market Operations (OMOs) ? What are the different money market instruments ?
- (f) How are the G-Secs issued ?
- (g) What is Money Market ? Whether Certificate of Deposit is Money Market Instrument ?
- (h) What are the role and functions of FIMMDA & FBIL ?

(8×5 marks = 40 marks)

2. (a) What is Foreign Exchange Market and explain the factors affecting Foreign Exchange Markets ?
- (b) Calculate Current Assets of a Company from the following information :
- Inventory Turnover Ratio = 4 Times.
- Inventory at the end is ₹ 20,000 more than the Inventory in the beginning.
- Revenue from Operations ₹ 3,00,000 and Gross Profit is 20% of revenue from Operations.
- Current Liabilities = ₹ 40,000
- Quick Ratio = 0.75 : 1
- (6 marks each)
3. (a) Explain RBI's New Guidelines On "Commercial Papers and Non-Convertible Debentures".
- (b) What is CKYC ? How does CKYC work ?
- (c) Explain the Step-by-Step Process of Claims to be settled for the Farmers under Pradhan Mantri Fasal Bima Yojana.
- (4 marks each)
4. (a) Gajamukha Fuel Injections Pvt Limited is a unit enjoying FBWC Limit of ₹ 50 Lakhs. Margin stipulated against Stocks is 25% and for Book debts is 50% as per the sanctioned terms and Conditions. Stale stocks and book debts outstanding beyond 90 days are not considered for DP calculation. The Stock statement dated 31.01.2025 is received on 05.02.2025. As per the Stock statement, Value of Stocks is showing ₹ 45 Lakhs (₹ 5 lakh stocks are old) and value of Book Debts is ₹ 30 Lakhs of which ₹ 10 lakh worth debtors are 4 months old. Value of Sundry Creditors for purchases is ₹ 10 lakhs. The Borrower has also advised outstanding LC Backed Bills discounted of ₹ 10 lakhs.
- Based on these facts, calculate the Drawing Power for the company as per the given stock statement ?
- (4 marks)

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- (b) A person pays ₹ 64,000 per annum to the Bank, for 12 years at the rate of 10% per year. Find the Annuity.
(4 marks)
- (c) “One of the important requirements of the Lending Banker is to hold valid legal documents”. Explain the importance and Key Clauses of Loan Agreements/Documents in Lending Process of Banks ?
(4 marks)
5. (a) Explain the revised guidelines of RBI on appointment of Whole-Time Director(s) in Banks.
(3 marks)
- (b) PRAVAAH Portal introduced by Reserve Bank of India for individual and entity’s purpose. Explain three major initiatives of PRAVAAH.
(3 marks)
- (c) What are the characteristics of a Self-Regulatory Organization(s) (SRO) in FinTech as defined by Reserve Bank of India ? What are the functions of an SRO in FinTech ?
(6 marks)
6. (a) When does RBI Invoke Prompt Corrective Action (PCA) on commercial banks ?
(4 marks)
- (b) A draft for ₹ 1,30,000 was purchased by a Govt. department in favour of a contractor. The same was sent by post. The draft is lost probably while in transit. The Govt. Dept. requests for issuance of duplicate draft and it is not in favour of giving an indemnity. As a practicing Banker, how will you act in the matter ?
(4 marks)

- (c) Mr. 'X' an employee of ABC Ltd, who visits the Bank frequently for deposits and payments, withdrew a sum of ₹ 1 lakh on 16.5.2024. On 17.5.2024 Mr. 'D', director of the Company comes to the bank and informs that the employees Mr. 'X' was removed from service on 12.5.2024. The company denied that it had issued the cheque for Rs. 1 lakh that was paid on 16.5.2024. On scrutiny, it was found that the signature of the director on the cheque was forged. The director demanded for the refund of the money.

The Bank took the stand that it was a small amount and the cheque was paid in good faith. Discuss.

(4 marks)

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