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Banking - 2

Q.1 Consider the following statements in the context of Payment Bank:

1. **The idea of Payment Bank was mooted Based on the recommendations Narsimhan Committee.**
2. **The payment banks can accept Demand Deposits as well as Time Deposits.**
3. **The deposit limit for an individual account is 2 Lakh rupees.**

Which of the above-mentioned statements is/are correct?

A. 2 and 3

B. Only 3

C. 1 and 3

D. None of the above.

Answer: B

Explanation

Payment Banks

- Committee on Comprehensive Financial Services for Small Businesses and Low-Income Households headed by Dr. Nachiket Mor recommended setting up of Payment Banks.
- The committee examined the issues relevant to a ubiquitous payments network and universal access to savings and recommended, the Pre-paid Payment Instruments Issuers (PPI issuers) should apply for a payments bank license or become Business Correspondents (BCs).
- The payments banks are registered as a public limited company under the Companies Act, 2013, and licensed under Section 22 of the Banking Regulation Act, 1949.
- Legislative framework for Payment Banks:
    - Banking Regulation Act, 1949;
    - Reserve Bank of India Act, 1934;
    - Foreign Exchange Management Act, 1999;
    - Payment and Settlement Systems Act, 2007;
    - Deposit Insurance and Credit Guarantee Corporation Act, 1961
    - Examples of PBs: Airtel Payments Bank, India Post Payments Bank,
    - After reviewing the performance of the existing PBs RBI in April 2021 raised the limit of deposit from 1 lakh to 2 lakh.
- Functions:
    - The payments bank would be permitted to set up its own outlets such as branches, Automated Teller Machines (ATMs), Business Correspondents (BCs), etc. to undertake only certain restricted activities permitted to banks under the Banking Regulation Act, 1949,

- Acceptance of demand deposits, i.e., current deposits, and savings bank deposits from individuals, small businesses and other entities, as permitted.

- What Payment Banks Cannot do?
    - The Payment Banks cannot set up subsidiaries to undertake non-banking financial services activities.
    - The PBs cannot accept Time deposits.
    - No NRI deposits should be accepted.

Q.2) Which of the statements mentioned below is correct in reference to e-Rupi?

1. **It is a cashless and contactless instrument for digital payment voucher which a beneficiary gets on his phone in the form of an SMS or QR code.**
2. **It is developed by National Payments Corporation of India (NPCI).**

Select the correct answer from the given options below.

A. Only 1

B. Only 2

C. Both 1 and 2

D. Neither 1 nor 2

Answer: C

Explanation

- e-RUPI is a digital voucher which a beneficiary gets on his phone in the form of an SMS or QR code.
- It is a pre-paid voucher, which he/she can go and redeem it at any center that accepts its.
- e-RUPI is a one-time contactless, cashless voucher-based mode of payment that helps users redeem the voucher without a card, digital payments app, or internet banking access.
- How it works?
    - If the Government wants to cover a particular treatment of an employee in a specified hospital, it can issue an e-RUPI voucher for the determined amount through a partner bank.
    - The employee will receive an SMS or a QR Code on his feature phone / smart phone. He/she can go to the specified hospital, avail of the services and pay through the e-RUPI voucher received on his phone.
    - The National Payments Corporation of India (NPCI), which oversees the digital payments ecosystem in India, has developed e-RUPI, a voucher-based payments system to promote cashless transactions.

Q.3 Consider the following statements in the context of Liquidity Trap:

1. **Liquidity Trap is an expansionary economic situation in which interest rates are very high.**
2. **In such situation people tend to invest more because interest rates are high and save less.**

Which of the statements mentioned above is/are correct?

A. Only 1

B. Only 2

C. Both 1 and 2

D. Neither 1 nor 2

Answer: D

Explanation

- Liquidity Trap
  - It was described by economist John Maynard Keynes.
  - Liquidity Trap is a Contractionary Economic Situation in which interest rates are very low.
  - During a liquidity trap, consumers choose to avoid bonds/investments and keep their funds in cash savings because of the prevailing belief that interest rates could soon rise.
  - The saving rates are very high as people tend to save more as interest rates are low. In such situation even the additional money supply doesn't motivate people to invest and people save more hence it creates a Liquidity Trap.
- How to come out of Liquidity Trap?
  - Reduce the cost of borrowing, making loans more attractive. It will motivate people to invest more.
  - Quantitative easing to increase the money supply with the banks to lend more. But this can cause inflation
  - Helicopter Drop- it is suggested by Milton Friedmann. According to him money shall be dropped directly with the consumer instead of the intermediary institutions like banks. This was suggested by Friedmann to stop people from saving extra.

Q.4 Consider the following statements in the context of Marginal Cost of funds-based Lending rate (MCLR):

1. **It is the percentage of lending amount which a borrower must deposit in the loan account for availing a loan from bank.**
2. **The methodology for calculating MCLR is determined by the Banks Board Bureau.**

Which of the above-mentioned statements is/are incorrect?

A. 1 only

B. 2 only

C. Both 1 and 2

D. Neither 1 nor 2

Answer: C

Explanation

- MCLR is an internal benchmark or reference rate for the bank.

- MCLR describes the method by which the minimum interest rate for loans is determined by a bank - on the basis of marginal cost or the additional or incremental cost of arranging one more rupee to the prospective borrower.
- The MCLR methodology was introduced by the Reserve Bank of India with effect from April 1, 2016.
- All the loans made by banks would be priced with reference to the Marginal Cost of Funds based Lending Rate (MCLR) which will be the internal benchmark (means a reference rate determined internally by the bank) for such purposes.
- MCLR or marginal cost of funds-based lending rate has been introduced so that end borrowers can enjoy the benefits associated with repo rate cuts by the Reserve Bank of India (RBI).
- This has been implemented to make banking system even more transparent.
- MCLR depends on factors like CRR (Cash Reserve Ratio), marginal cost of funds, tenor premium, and operating cost.
- Marginal cost of funds-based lending rate can be different for different loan tenures.
- The principal objective of the Marginal Cost of Funds Based Lending Rate is listed as follows:
    - Improving the transmission of the policy rate into lending rates of the bank.
    - Bringing transparency in the methods followed by various banks for the determination of interest rate.
    - Ensuring the availability of bank loans at rates that fair to both lenders and borrowers.
    - Enabling the lender and bank to be competitive and improve their worth in the long run.

Q.5 Which of the following is correct in the context of Liquidity Adjustment Facility (LAF)?

1. **LAF is extended by RBI to the scheduled commercial banks and RRBs to avail of liquidity in case of requirement.**
2. **Repos and Reverse Repos are the tools used to perform the operation of LAF.**

Select the correct option from the given codes below:

A. 1 only

B. 2 only

C. Both 1 and 2

D. Neither 1 nor 2

Answer: B

Explanation

- LAF is a facility extended by the Reserve Bank of India to the scheduled commercial banks (excluding RRBs) and primary dealers to avail of liquidity in case of requirement or park excess funds with the RBI in case of excess liquidity on an overnight basis against the collateral of Government securities including State Government securities.

- LAF is used to aid banks in adjusting the day-to-day mismatches in liquidity (frictional liquidity deficit/surplus).
- It enables liquidity management on a day-to-day basis.
- The operations of LAF are conducted by way of repurchase agreements (repos and reverse repos) with RBI being the counter-party to all the transactions.
- The rate charged by RBI for this transaction is called the repo rate. Repo operations therefore inject liquidity into the system. Reverse repo operation is when RBI borrows money from banks by lending securities.
- The interest rate paid by RBI is in this case is called the reverse repo rate. Reverse repo operation therefore absorbs the liquidity in the system.