A Primer on
Essential Terms of JAIIB/CAIIB

Essential Glossary For JAIIB/CAIIB-All Modules

- **AD-HOC TREASURY BILLS:** The Reserve bank of India Act enables the **Bank to make advances repayable within 3 months to the Central Government and the State governments**. To the **Central Government the advance is made against Ad Hoc Treasury Bills.** Thus **these are the bills issued by the Central government** specifically **to the RBI for obtaining financial accommodation to meet the temporary gap between receipts and expenditure of the Government.** These bills **were being automatically created when the Union Government's balance with RBI fell short of the stipulated minimum level of Rs. 50 crore on any Friday,** but were cancelled when the Central Government got replenishment up to the stipulated level. **This results in automatic monetization of government deficit.** In April 1997 the practice of issuing **Ad-hoc treasury Bills was discontinued** and a system of granting of **Ways and Means Advances (WMA)** was introduced. **The interest rate originally charged at Bank Rate has been linked to the Repo Rate** as it emerged as a short term reference rate. **The drawings over and above the sanctioned limits (over draft) for any year are charged at Repo Rate plus 2 percentage points.**
- **AMERICAN DEPOSITORY RECEIPTS (ADRs) :** ADRs/GDRs are receipts (not shares) issued by an **American Depository or any Global Depository to prospective investors abroad, giving them the title to underlying shares of an Indian company.** These receipts are listed by the company issuing the ADR/GDR on foreign exchanges (in American exchanges, it is called ADR and called GDR-or Global Depository Receipts if listed in international exchanges) and traded just like a share. An ADR/GDR can represent any number of underlying shares. All ADRs are a form of GDR. **Corporates are allowed to access foreign equity capital in the form of ADR/GDR under an automatic route.**
- **ARBITRAGE:** The process of buying a thing in one market and selling it at the same time in another market, making a quick profit, by taking advantage of the **price difference**.
- **ASIAN CLEARING UNION (ACU): The Asian Clearing Union (ACU) was established with its head quarters at Tehran, Iran** on December 9, 1974 at the initiative of the **United nations Economic and Social Commission for Asia and Pacific (ESCAP)**, as a step towards securing regional co-operation. The ACU is a system for **clearing payments among the member countries on a multilateral basis**. The central banks and monetary authorities of **Iran, India, Bangladesh, Bhutan, Nepal, Pakistan, Sri Lanka and Myanmar** are the members of the ACU. ACU is the simplest form of payment arrangements whereby the members settle payments for intra-regional transactions among the **participating central banks on a multilateral basis.** The main objectives of a clearing union are to facilitate payments among member countries for eligible transactions, thereby economizing on the use of foreign exchange reserves and transfer costs, as well as promoting trade among the participating countries. **The Asian Monetary Unit is the common unit of account of ACU and is equivalent in value to one U.S.Dollar.** The Asian Monetary Unit may also be denominated as ACU dollar. All instruments of payments are required to be

denominated in **Asian Monetary Unit**. Settlement of such instruments may be made by authorized dealers through operation on ACU dollar Accounts. Reserve Bank of India undertakes to receive and pay U.S. dollars from/to **authorized dealer** for the purpose of funding or for repatriating the excess liquidly in the ACU dollar accounts maintained by the authorized dealer with their correspondents in the other participating countries. Similarly, the Reserve bank of India has also been receiving and delivering U.S. dollar amounts for absorbing liquidity or for funding the **ACU dollar (vostro) accounts maintained by the authorized dealers on behalf of their overseas correspondents.**

- **ASSET BACKING FOR ISSUE OF NOTES:** The RBI Act stipulates that the assets of the Issue Department against which currency notes are issued have to consist of gold coin and bullion, foreign securities, rupee coin, Government of India rupee securities of any maturity and bills of exchange and promissory notes payable in India which are eligible for purchase by the bank. So far such bills have not formed part of the assets of the Issue Department. **The aggregate value of gold coin and gold bullion and foreign securities held in the Issue Department should not at any time be less than Rs 200 crore; of this, value of gold, not to be less than Rs 115 crore**. There is no ceiling on the amount of notes that can be issued by the Reserve Bank at any time. This method of issue of notes with assets backing is known as **Minimum Reserves Method**

- **ASSET CLASSIFICATION:** A recommendation of **high level Committee on Financial System (Narasimham Committee)** is that the **policy of income recognition should be objectively based on record of recovery**. International practice is that an asset is treated as non-performing when interest is overdue for at least 90 days. Recognizing the need that a balance sheet should reflect a bank's actual financial health, **a system for recognition of income, classification of assets and provisioning for bad debts on a prudential basis was introduced.** The assets portfolio of the banks is required to be classified as **(1) standard assets (2) sub-standard assets (3) doubtful assets and (4) loss assets.** Standard asset is one that does not disclose any problems and which does not carry more than normal risk attached to the business .An asset which has been classified as NPA for a period not exceeding 12 months is considered as sub-standard asset. Doubtful asset is one which has remained NPA for a period exceeding 12 months. An asset which is considered uncollectable and loss has been identified by the bank or internal or external auditors or the RBI inspection and the loss has not been written off is regarded as loss asset.

- **ASIAN DEVELOPMENT BANK (ADB) :** ADB is a multilateral development financial institution, established in 1966, to promote economic and social development in Asian and Pacific countries through loans and technical assistance. It was founded in 1966 with 31 member-states and has now grown to 67 (48 from the region and 19 from other parts of the globe) and having its head quarters at **Manila (Philippines)**.

- **ASSET LIABILITY MANAGEMENT (ALM) :** Denotes a scientific way of **measuring, monitoring and managing the various risks banks or financial**

institutions which are exposed during the course of their operations. **Earlier banks had concentrated essentially on credit and investment portfolios and liquidity and profitability were given prime importance in the distribution of assets.** Accumulation of **mismatches among items on balance sheet and off balance sheet accounts often led to liquidity crisis and even insolvency**. In the process of globalisation of economy, banks are exposed to various kinds of risks. Risk management involves continuous process of planning, organising and controlling the volumes, maturities, rates and yields of assets and liabilities. To help achieve this the RBI has issued Asset Liability Management guidelines **to form part of the management of credit, market and operation risks. Thrust of ALM is on managing market risk.**

- **ASSET RECONSTRUCTION COMPANIES(ARCs) :** These companies specialise in the **recovery and liquidation of sticky assets of the banks and financial institutions.** The non-performing assets can be assigned to ARC **by banks at discounted price**. In India the **Committee on Financial Systems (1991) recommended creation of Asset Reconstruction Fund (ARF).** The **committee on Banking Sector Reforms (1998)** suggested creation of **Asset Reconstruction Company to which sticky advances of banks can be transferred**. ARF was also considered essential as part of the comprehensive restructuring of weak banks. In pursuance of all this legislation to regulate **Securitization and Reconstruction of Financial Assets and Enforcement of Security interest (SARFAESI Act 2002)** was passed by the Parliament.

- **ASSET SECURITISATION:** It is a process by which **non-tradable assets are converted into tradable securities.** Illiquid **assets such as mortgage loans, auto loan receivable, cash credit receivables etc. on the balance sheet of the originator (such as Housing Finance Companies, Financial Institutions, banks etc.)** are packaged, underwritten and sold in the form of **securities** to investors through a carefully structured process called **SECURITISATION**. These securities could be in the form of **Commercial Paper, Participation Certificates, Notes or any other form of security permissible under the legal framework of the country**. In a securitization process, the underlying assets are used both as collateral and also to generate the income to pay the principal and interest to the investors of the asset backed securities.

- **AUTHORISED DEALERS:** Scheduled commercial banks and other banks and financial institutions **authorized to deal in foreign exchange are known as authorised dealers**. The Reserve Bank has been delegating powers to authorised dealers for undertaking foreign exchange transactions without obtaining Bank's prior approval.

- **BALANCE OF PAYMENT ACCOUNTS(BoP):** A country's **balance of international payment** is a systematic **statement of all economic transactions between the country and the rest of the world.** The statistical statement for a period mainly show (1) transactions in goods, services and income between the economy and the rest of the world, (2) changes of ownership and other changes in that economy's monetary gold, **Special Drawing Rights (SDRs)** and claims and liabilities to the rest of the world. Like other accounts, the balance of payments records each transaction either a plus or a minus. If a transaction earns foreign currency for the nation it is called a credit and if a transaction involves spending foreign currency it is debit. **The two major components of balance of payments are balance on current account and balance on capital account. Balance on current account summarises the difference between nation's total exports and imports of goods and services and capital account balance depicts changes in loans or investments that private citizens or government make or receive from foreign private citizen or governments.**

- **BALANCE OF TRADE (BoT):** International trades is made up of purchase and sale of goods between countries and are collectively called imports and exports. **Exports and imports are visible trade**. **The difference between exports and imports is called balance of trade.** The balance of trade is favorable when the **value of exports exceeds imports (trade surplus) and unfavorable or adverse when value of imports exceed exports (trade deficit).** Transactions in services relate to payment and receipt for services such as shipping, insurance, travel and tourism, transfer of interest, migrant remittances, interest and dividend payments, etc. **These services are called invisibles**. **Trade in goods and services constitute the current account**. In **addition, there are capital transactions in the form of payments and receipts due to transfer of funds for acquiring assets, extension of credits and loans, investments etc**. These **three groups of economic transactions constitute the balance of payments of a country.**

- **BANK CREDIT TO COMMERCIAL SECTOR:** This **denotes credit extended by RBI to commercial sector by investing in shares/bonds of financial institutions, ordinary debentures of cooperative institutions and loans to financial institutions and bills discounted by commercial banks with RBI and other banks.** Other bank's credit to commercial sector is in the form of loans, cash credit, overdrafts, bills discounted and investment in approved securities and other investment.

- **BANK CREDIT TO GOVERNMENT :** Reserve Bank Credit to Government is **the sum of the claims of the bank on the Central Government in the form of holdings of dated securities, ways and means advances(WMAs), Treasury Bills(T-Bills) and rupee coins. These assets minus the Centre's cash balances with the RBI give Net RBI Credit to Central Government**. Net RBI Credit to State Governments comprises **loans and advances to state Governments, less their deposit balance with banks. Other banks' credit to Government represents their investments in long term and short- term Government securities.** Bank credit to Government is one of the factors **explaining the variations in money supply.** Other factors giving rise to change are **RBI credit to commercial sector, other banks' credit to commercial sector, government's currency liabilities, net foreign exchange asset of RBI and other banks, and net non-monetary liabilities of RBI and banks.**

- **BANK RATE :** An instrument of general **credit control and represents the standard rate** at which **the RBI is prepared to buy or rediscount bills of exchange or other commercial paper eligible for purchase under the provisions of the Act.** This rate is **also known as Rediscounting Rate** The Bank Rate influences the cost of financial accommodation extended by RBI. The impact of a change in the Bank Rate depends **upon such factors as the extend of commercial banks' dependence on the Reserve Bank for funds, the availability of funds to banks from other sources,** the extent to which other interest rates are directly influenced by changes in the Bank Rate, and the degree of importance attached to a change in the Bank Rate as an indicator of the stance of monetary policy.

- **BANKING CODES AND STANDARD BOARD OF INDIA (BCSBI) :** This Board was set in pursuance of a **recommendation of the Committee on Procedures and Performance Audit on public services under the Chairmanship of Shri S.S.Tarapore** to benchmark the existing **level of public services in the banking sector**. This is an autonomous body established by the RBI and the banks to evaluate and oversee the observance of **voluntary code of conduct by the banks. BCSBI was set up to ensure that the common person as a consumer of financial services from the banking Industry is in no way at a disadvantageous position and really gets what he/she has been promised.** The Scheme of **Banking Ombudsman**, which has been functioning for quite some time, does not look into systemic issues with a view to enforcing a prescribed **quality of service**. Ideally, such a function should be performed by a **Self-Regulatory Organisation (SRO)** but in view of the existing framework of the banking sector in India, it was felt that an independent, autonomous Board will be best suited for the function. Therefore, **Dr. Y.V. Reddy, then Governor,** Reserve Bank of India, in his Monetary Policy Statement (April 2005) announced setting up of the Banking Codes and Standards Board of India in order to ensure that a comprehensive code of conduct for fair treatment of customers was evolved and adhered to.

- **BANKING DEPARTMENT :** The primary function of Reserve Bank regarding note issue and general banking business are performed by two separate departments viz. Banking Department and Issue Department. The Banking Department is entrusted with the task of handling general banking business in particular, handling of transaction arising from the bank's duties as Banker to Government and to the banks.

- **BANKING OMBUDSMAN SCHEME : The Banking Ombudsman Scheme was introduced in 1995 under the provision of Banking Regulation Act 1949 covering scheduled commercial banks and scheduled primary cooperative banks and Regional Rural Banks having business in India.** The scheme is intended to establish a system of Banking Ombudsman for expeditious and inexpensive resolution of customer complaints. Any person whose grievance against a bank is not resolved to his satisfaction with in a period of two months after the bank received the complaint can approach the Banking Ombudsman if the complaint of the deficiency of service is pertaining to any of the matters specified in the scheme. Presently **15 Banking Ombudsman Offices** administer the scheme in the country. Apart from enabling resolution of complaints relating to provision of banking services by mediating between the bank and the aggrieved party or by passing an award in accordance with the scheme, Banking Ombudsman endeavours to resolve disputes by way of **arbitration between one bank and its constituents, as well as between one bank and another bank** as may be agreed upon by the contesting parties in accordance **with the provisions of the B.O scheme and Arbitration and Conciliation Act 1986.**

- **BANKING SYSTEM**: **Banking system consists of commercial banks and cooperative banks. The former include Indian banks in public sector, private sector and foreign banks.** Among the commercial banks, **public sector banks (The State Bank of India and its associate banks and the 20 Nationalised banks)** account for predominant share of bank deposits.
  - ★ **Private sector banks-old as well as the new banks,** which came into being following the recommendation of Committee on Financial System 1991 to induce greater competition and efficiency-are banking companies and are governed by the provisions of Banking Regulation Act 1949.
  - ★ The **cooperative banking structure** providing banking access to the rural masses is federal in character. **State cooperative banks (SCOBs), district central cooperative banks (DCCBs) and primary agricultural societies(PACS)** specialise in **short-term credit** while **state cooperative agriculture and rural development banks and primary cooperative agriculture and rural development banks** provide long term loans and advances. **Urban Cooperative banks (UCBs) finance small business in urban and semi urban areas.**
  - ★ **Regional Rural Banks** are subsidiaries of commercial bank which are specially set up in rural areas to provide credit and other facilities to weaker sections for productive activities in agriculture, trade, industry, etc. Besides there are a few **Local Area Banks(LABs)** functioning in a few states. The government owned post office savings bank is a distinct entity in the sense that it is oriented towards mobilisation of small savings of the community and does not undertake lending activity.
- **BANK FOR INTERNATIONAL SETTLEMENTS (BIS) :** The Bank for International Settlements was set up in 1930 and is situated in Basle. Under article 3 of the Bank's statute, the basic object is to promote cooperation among **central banks and as such is designated as "Central Banks' Bank".** It carries out a wide range of banking operations arising from the task of assisting the Central Banks in managing and investing their monetary reserves. BIS acts as trustee or agent for a number of international bodies or arrangements, in the execution of international payment agreements. **The BIS currently has 55 member central banks.**
- **BASEL COMMITTEE ON BANKING SUPERVISION (BCBS) :** The Basel Committee is a committee of bank supervisors drawn from **13 member countries** (Belgium, Canada, France, Germany, Italy, Japan, Luxembourg, The Netherlands, Spain, Sweden, Switzerland, United Kingdom and United State of America). It was

founded in 1974 to ensure international cooperation among a number of supervisory authorities. **It usually meets at the Bank for International settlements in Basel, Switzerland,** its permanent Secretariat. **The Committee framed three Capital Accords, Basel I (1988) and Basel II (1999) and Basel III (2010–11).**

The differences in these Accords are as follows:

Basel I	Basel II
Only Credit Risk (Although included capital for market risk subsequently in 1996)	Credit, Market and Operational Risk
Credit Risk: One measure fits all - Broad-brush approach	Based on Underlying Risk
Single Risk Measure: Minimum Capital Requirement	Package of Minimum Capital Requirement, Supervisory Review Process and Market Discipline working complementary to each on **three pillars approach**

- **BENCHMARK PRIME LENDING RATE (BPLR):** Prime Lending Rate calculated after considering cost of funds, operating expenses, regulatory provisioning, capital charge and profit margin. It forms the reference rate for pricing of loans and advances.
- **BHARATIYA RESERVE BANK NOTES MUDRAN PRIVATE LTD (BRBNMPL) :** Bharatiya Reserve Bank Notes Mudran Private Limited was set up as a wholly owned subsidiary of RBI in 1995, to take up the work of two note presses, one each at **Mysore and another in Salboni in 1986**. The BRBNMPL arranges to print and supply the bank notes to the issue offices of the RBI according to the requirement and production target set in consultation with the GOI and RBI.
- **BOARD FOR FINANCIAL SUPERVISION (BFS) :** This was constituted in November 1994, under the Central Board of Directors of RBI with a view to give undivided attention to supervision of **banks, all India financial institutions and NBFCs.** It functions within the framework of **RBI (BFS) Regulation 1994** exclusively framed for the purpose in consultation with Government of India. **The Governor of RBI is the Chairman of the Board and four non-official directors of the Central Board are the members. The Deputy Governors of RBI are the Ex-officio members.**

- **BOARD FOR REGULATION AND SUPERVISION OF PAYMENT AND SETTLEMENT SYSTEM (BPSS) :** As a committee of the Central Board of the RBI, **BPSS was set up in March 2005** to prescribe the policies relating to the regulation and supervision of all types of payments and settlements system, set standards for existing and future systems, authorise the payments and settlements systems etc. To assist the BPSS the RBI formed a new department called the Department of Payment and Settlement Systems.
- **CALL MONEY MARKET /NOTICE MONEY MARKET:** Refers to a **segment of money market where participants lend and borrow money on an overnight basis**. The notice money market provides for lending and borrowing of money at **a short notice for periods up to 14 days.** Since 1992 many financial institutions like **IDBI, NABARD, mutual funds, GIC and subsidiaries** were allowed to participate in the call money market. **On the recommendations of the Narasimham committee 1998, the non-bank participation in the market has been phased out** in order to make it a **pure inter-bank call/notice money market including primary dealers.**
- **CAPITAL ACCOUNT CONVERTIBILITY (CAC) : Convertibility means the ability of the domestic residents to convert the local currency to any foreign currency at will**. The Report of the **Committee on Capital Account Convertibility (Tarapore Committee 1997)** provided the following working definition of CAC**: "freedom to convert local financial assets into foreign financial assets and vice versa at market determined rates of exchange. It is associated with changes of ownership in foreign / domestic financial assets and liabilities and embodies the creation and liquidation of claims on, or by, the rest of the world. CAC can be, and is, coexistent with restriction other than on external payments"**. Broadly it would mean freedom for firms and residents to buy overseas assets such as equity, bonds, property and acquire ownership of overseas firms, besides free repatriation of proceeds by foreign investors.
- **CAPITAL ADEQUACY:** In the context of growing size and variety of banking transactions the prescription of minimum fixed capital for banks (as well as financial institutions) was considered inadequate The Committee on Banking Regulation and Supervisory Practices, set up by the Bank for International Settlements **(BASEL COMMITTEE)** prescribed certain capital adequacy standards taking into account the element of risk in various types of assets in the balance sheet and off-balance sheet business. Under this system, the **funded and non-funded items and other off-balance sheet exposures are assigned weights according to the risk perception and banks are required to maintain unimpaired minimum capital funds to the prescribed ratio on the risk weighted assets.** In India the **Capital adequacy norms were adopted in 1992, following the Basel Accord of 1988. This accord exclusively focussed on credit risk.** In the context of financial innovations and growing complexity of financial transactions a **new Capital Accord known as Basel II was released by the Basel Committee on Banking Supervision**. **The revised framework helps banks to determine the capital requirement for 3 types of risks such as 'credit risk, market risk and operational risk'**. This involves a **3-pillar**

approach of Minimum Capital Requirements, Supervisory Review Process and Market Discipline.

- **CAPITAL ADEQUACY, ASSET QUALITY, MANAGEMENT, EARNINGS, LIQUIDITY, SYSTEMS AND CONTROLS (CAMELS) :** Banks incorporated in India are supervised and awarded supervisory ratings under **CAMELS model**. The foreign banks operating in India are rated under CALCS which stand for Capital Adequacy, Asset Quality, Liquidity & Compliance and Systems. **A system of supervisory rating based on CAMELS is being used to assess the performance and strength and soundness of banks.**

- **CAPITAL FORMATION :** Refers to that part of a country's **current output and imports which is not consumed or exported during the accounting period but set aside as additions to its stock of capital goods for use in future productive process** - machinery, equipment, plants, buildings, stock of raw material, semi-finished goods, etc. Net capital formation is distinguished from gross capital formation in that it is measured after allowances are made for depreciation, obsolescence and accidental damage to fixed capital.

- **CAPITAL FUNDS OF BANKS :** Capital Funds **comprise of Tier I capital and Tier II capital as defined under Capital Adequacy Standards.** Tier I capital mainly consists of Capital, Statutory reserves, Capital reserves etc, reduced by equity investments in subsidiaries, intangible assets etc. Tier II capital consists of undisclosed reserves, revaluation reserves, general provision and loss reserve, subordinate debt instruments etc.

- **CAPITAL MARKET:** This is an important part of financial sector and **refers to a system which provides for facilities and arrangements for rising capital, borrowing and loaning of long term funds**. Capital market consists of **primary market and secondary market**. The primary market or new issue market facilitates mobilisation of resources through public issue (by prospectus) right issues (through letter of offer) and private placements. Apart from equity shares and preference shares, a number of innovative instruments have been lately introduced in the primary market. The secondary market provides liquidity through sale and marketability of these instruments.

- **CASH RESERVE RATIO (CRR) :** This term refers to a **policy instrument to control money supply.** The Reserve Bank of India Act requires the **scheduled banks to maintain a minimum average daily cash balance equivalent to a specified percentage of their Time and Demand Liabilities(DTL)** in India outstanding as on the Friday of the **previous fortnight.** This is known as Cash Reserve Ratio. The RBI is empowered to vary the Cash Reserve Ratio between **3 percent and 20 percent** depending on the prevalent monetary conditions. **Total cash reserves actually maintained by a scheduled commercial bank may consist** of **(1) the minimum CRR of 3% or prescribed CRR (2) additional cash reserves relating to incremental demand and time liabilities (DTL) and (3) excess cash reserves over and above the level required to comply with the prescribed cash reserve**

requirement or short fall therein. Following the amendment of the **Reserve Bank of India Act in 2006**, the Reserve Bank, keeping the needs of securing monetary stability in the country, **can prescribe CRR for scheduled commercial banks without any floor rate or ceiling rate.**

- When there is a change in CRR, the first impact is felt by the banks. For banks, **a rise in CRR would mean that a larger proportion of their lendable resources will be with RBI**, while **a fall in the rate will mean a lower proportion will be with the Central Bank. An increase in CRR would also mean that money is being sucked out of the system.** This would mean that funds are hard to come by and hence banks will have to pay more to depositors in order to induce them to keep their funds with banks. This will push up cost of funds for banks. The banks therefore will also have to raise lending rates in order to meet the increased cost while maintaining their margins. **Raising CRR is a measure used by the RBI to contain inflation by mopping up excess liquidity in the economy.**
- **CENTRAL RECORD AND DOCUMENTATION CENTRE (CRDC) :** This was established in **August 1981 in Pune** with the **object of serving as a repository of non-current permanent records and as the central archives of the Reserve Bank of India** for research purposes. It maintains an archival of RBI library, and provides for repairs and rehabilitation of records of RBI in a scientific manner and research facilities for the staff of the Bank as well as students from other institutions.
- **CHANNELS OF INFLUENCE OF INTERVENTION IN EXCHANGE RATES :** The four channels of influence of intervention in exchange rates are: **1) Monetary Policy Channel** - Effect on domestic interest rates, when intervention is not fully sterilized; **2) Portfolio Balance Channel -** Composition of domestic and foreign assets held by the main market participants changes as a result of sterilized intervention; **3) Signalling or Expectations Channel -** Sterilized intervention changes private agents' exchange rate expectations by giving signals about the future stance of monetary policy and **4) Order Flow or Micro Structure Channel** - impact of intervention on buy or sell orders of traders who follow past market trends.
- **CLEARING CORPORATION OF INDIA LTD (CCIL) :** This was set up in November 2002 to serve as an industry-wise organization for **clearing and settlement of trades in foreign exchange government securities and other debt instruments**. The CCIL manages various risks and reallocates risks among the participants. **CCIL reduces the liquidity requirements of the market and thereby liquidity risk of the system.**
- **CODE OF BANKS COMMITMENT TO CUSTOMERS :** A code evolved by the **Indian Banks' Association and Banking Codes and Standard Board of India to provide a framework for minimum standard of banking services** which individual customers can legitimately expect. It sets out a minimum standard of customer service with reliability, transparency and accountability and outlines how each bank expects to deal with the customers day to day requirements and accordingly what each

customer should reasonably expect from his bank. **The code was released in July 2006.**

- **COINAGE :** Coins are minted in the denominations of 10paise, 20paise, 25paise, 50paise, 1rupee, 2rupees, and 5rupees. Coins up to 50paise are called small coins and other coins are termed as rupee coins As per the provisions of Coinage Act 1906, coins can be issued up to denominations of Rs 1000/-. **The responsibility for coinage vests in the Government of India in terms of Coinage Act 1906.**
- **COLLATERALISED BORROWING AND LENDING OBLIGATION (CBLO):** CBLO is a **money market instrument**. Conceptually, it is (**1) an obligation by the borrower to return the money borrowed, at a specified future date, (2) an authority to the lender to receive money lent, at a specified date and (3) an underlying charge on securities held in the custody with Clearing Corporation of India Limited (CCIL) for amount borrowed**. CBLO is a **new money market instrument developed by CCIL. It is a hybrid of repo (backed by securities) and call money products (short term). Consistent with the move to phase ou**t **non-bank participants from the call money market, CBLO was introduced to facilitate participation of non-bank entities in money market.** Borrowing under CBLO is against the collateral of Government securities. CBLO also has certain other features such as maturity period ranging from **1day to 1year** and is issued in **electronic book entry form only**. The CCIL provides the trading platform and **market participants (Banks, Financial Institutions, Insurance Companies, Mutual Funds, Primary Dealers, Non-Banking Financial Companies, Corporations etc) decide the rate at which it is issued and traded**.
- **COMMERCIAL PAPER (CP) :** A money market instrument, this represents an **unsecured usance promissory note negotiable by endorsement and delivery**. This instrument was conceived as a short term substitute for working capital borrowing by the **High Net worth companies (HNCs).**
- **CONSOLIDATED SUPERVISION:** Consolidated Supervision refers to system whereby the RBI undertakes **consolidated supervision of bank groups (with related to entities) where the controlling entity is an institution (banks, financial institution or NBFCs) which comes under the regulatory/supervisory purview of the RBI.** The components of consolidated supervision are **(1) Consolidated financial statements (CFs) (2) consolidated prudential reports (CPR) and (3) application of certain prudential regulations like capital adequacy, large exposure, risk concentration etc. on group basis**. CFs would include consolidated balance sheet, profit and loss account and other statements including cash flow statements
- **CONTAGION:** Phenomenon when one country's economy is shaken because of changes in the asset prices of another country's financial market.
- **CORPORATE GOVERNANCE :** The concept of Corporate Governance is differently defined. It means doing everything better to improve relationship between companies or organizations and their shareholders and other stakeholders. **It is also defined as a system by which business operations are directed and controlled.** It

specifies the distribution of rights and responsibilities among different participants in the corporation such as the board, managers, shareholders and other stakeholders and spells out the rules and procedures for making decision on corporate affairs.Corporate governance is becoming crucial for banks and financial institutions to promote effective risk management and financial stability. As part of financial sector reforms banks are required to follow **due diligence procedures for appointment of directors on the boards of private sector banks and regarding role and responsibilities of independent directors.** Banks are also required to take steps to strengthen risk management framework and constitute various committees in conformity with corporate governance. The purpose is to ensure that owners and managers of banks are persons of sound integrity so as to protect the interest of depositors and integrity of financial system.

- **COUPON RATE:** Refers to the **interest rate fixed to the bond/security** or **debentures.**
- **CREDIT POLICY:** Refers to the policy of using central banking instruments for varying the cost, availability and direction of credit or **"loans and discounts"** extended by the banks to their customers. **The capacity of banks to provide credit depends on their cash reserves (cash in hand and balances with Reserve Bank of India**; substantial portion of the reserves is held in the form of balance with RBI). These reserves increase through a rise in the deposits of banks or their borrowings from Reserve Bank or a sale of their investments. Regulations of credit essentially means regulation of quantum of reserves of banks. **If the RBI desires to bring about credit expansion it would adopt measures to help augment reserves; if credit expansion is to be restricted, measures to curtail the reserves are adopted.**
- **CREDIT INFORMATION BUREAU OF INDIA LTD (CIBIL) :** This is an agency for compilation and dissemination of credit information covering data on defaults to the financial system. Banks and financial institutions are required to submit periodical requisite data to CIBIL and report to the RBI. With a view to strengthen the legal mechanism and facilitating credit information bureau to collect, process and share credit information on borrowers of banks /FIs the **Credit Information Companies' (CICs)Regulation Act** was passed and came into vogue with the President of India giving assent in June 2005. The Act empowers CIBIL to collect information relating to all borrowers and confers upon the RBI the power to determine policy in respect of functioning of credit information companies.
- **CREDIT RISK MEASUREMENT:** The Basel Accord permit Banks a choice between **two broad methodologies for calculating their capital requirements for credit risk. i) Standardised Approach:** One alternative will be to measure credit risk in a standardised manner, supported by external credit assessment. **ii) Internal Rating Based Approach:** Subject to certain minimum conditions and disclosure requirements, banks that have received supervisory approval to use IRB approach may rely on their own internal estimates of risk components in determining the capital requirement for a given exposure. **The risk components include measures of the**

probability of default (PD), loss given default (LGD), the exposure at default (EAD) and effective maturity (M). Under IRB Approach, the accord has made available two broad approaches: a foundation and an advanced. **Under the foundation approach, as a general rule, banks provide their own estimates of PD and rely on supervisory estimates for other risk components.** Under the **advanced approach, banks provide for more of their own estimates of PD, LGD and EAD and their own calculation of M, subject to meeting minimum standards.**

- **CURRENCY:** Paper currency, a medium of exchange, stands out as an important landmark in the evolution of payment system for various transactions, from the primitive barter of early societies to coins, credit cards and electronic money. **As against physical coins possessing intrinsic value, the paper currency represents a promise to pay the physical equivalent or the underlying value.** In the West, currency was introduced around the 17th century. In India up to 1861 from the latter part of the 18th century, banks were free to issue currency notes which were payable to bearer on demand. **These promissory notes, convertible into coins on demand were termed as bank notes**.Issue of official Government of India paper currency commenced in 1861 with the enactment **of Paper Currency Act**. With the formal inauguration of the Reserve Bank of India on 1-4-1935, the RBI took over the function of issuing notes. **The Indian currency is called Indian rupee and sub-denomination is called the paise.**

- **CURRENCY BOARD :** Currency Board issues currency in accordance with certain strict rules; the Board prints domestic currency and commits itself to converting it on demand to a specified currency at fixed rate of exchange. To make this commitment credible the board holds **reserves of foreign currency (or of gold or some other liquid asset) equal to at least 100% of the domestic currency issue at the fixed rate of exchange.** The Board issues currency only when there are enough foreign assets to back it. The main advantage of Currency Board Systems is compels Governments **to adopt a responsible fiscal policy**. If the budget is not balanced the government has to persuade private banks to lend to it. Bullying the Central bank to print money is no longer an option; the currency board therefore will tend to produce more prudent fiscal policies than a malleable Central bank will.

- **CURRENCY CHESTS :** Currency chests are **storehouses where bank notes and rupee coins are stocked on behalf of the Reserve Bank of India.** The Reserve Bank of India has authorised selected branches of banks to establish Currency Chests in order to facilitate distribution of notes and coins across the country through other bank branches in their area of operation. **The currency chest is like a miniature Issue Department and notes held in the chests are not deemed to be in circulation and the coins held in chest form part of Issue Department.**

- **CURRENCY OPTIONS :** A contract where the purchaser of the option has the **right but not the obligation to either purchase (call option) or sell (put option) and the seller (or writer) of the option agrees to sell (call option) or purchase (put option) an agreed amount of a specified currency at a price agreed in advance and**

denominated in another currency (known as the strike price) on a specified date (European Option) or by an agreed date (American Option) in the future.

- **CURRENCY RISK :** The possibility that exchange rate changes will alter the expected amount of principal and return of the lending or investment.

- **CURRENCY VERIFICATION AND PROCESSING SYSTEM:** This is an electronic mechanical device designed for examination, authentication, and counting, sorting and online destruction of notes which are misfit for further circulation. The system is capable of sorting the notes on the basis of denomination, design and level of shortage. Notes are sorted into fit, unfit, reject and suspect categories.

- **CURRENT ACCOUNT CONVERTABILITY:** Refers to the **process of easing restrictions on current international transactions and liberalisation for payment of current transactions involving foreign exchange.** This is formalised by the country accepting the obligations of Article (Vii) of the **International Monetary Fund (IMF)** to refrain from imposing restrictions on the making of payments and transfers for current international transactions. With the introduction of Current account convertibility, **Authorized Dealers have been delegated extensive powers to provide foreign exchange for current account transactions purposes.**

- **DEBT RECOVERY TRIBUNALS (DRT) :** These tribunals are established under the **Recovery of Debt due to Banks and Financial Institutions Act 1993** for expeditious adjudication and recovery of debts due to Banks and financial institutions and for connected matters or incidental there to. Cases of recovery can be filed by Banks and financial institutions **with the DRT where the amount of debt is not less than Rs 10 lakh.**

- **DEFLATION: Denotes persistent fall in general price levels of goods and services. It should not be confused with decline in prices in one economic sector or fall in inflation rate (known as disinflation).** While productivity driven deflation in which costs and prices are pushed lower by technological advances is beneficial to the economy that reflecting sharp slump in demand, excess capacity and shrinking money supply is harmful to the economy.

- **DELIVERY VERSUS PAYMENT:** Execution of trade and trade settlements are the two stages involved in securities and funds transactions. There are two types of settlement systems. **(i) Differed Net Settlements (DNS) and (ii) Real Time Gross Settlements (RTGS) In DNS all claims and counter claims of participants are accumulated over a period of time and netted out to arrive a multilateral net payment position.** The RTGS on the other hand represents settlement of any transaction **involving claims and counter claims instantly on gross basis,** thereby obviating the need for clearing arrangement. While netting out under DNS reduces the liquidity requirement for the system, **RTGS mechanism eliminates default risks. The application of principles of RTGS in the context of securities settlement is called Delivery Vs Payment System.** In the case of Government securities transactions the selling banker signs a form for transfer of securities and the buying bank authorises transfer of funds from its account with the RBI.

- **DEMAND FOR MONEY:** A term often used in the context of the study of inter-relationship between money, output and prices, to explain why individuals and business hold money balances. The important motivations for holding money balances are (i) transaction demand signifying that people demand money to purchase goods and services (ii) asset demand relating to the desire to hold a very liquid risk free asset. In other approaches money holding is said to be resting on the basic variables of income and rate of return.

- **DEMONETISATION:** Refers to the policy of removal of certain currency from circulation or the discontinuance of the monetary unit of a nation the value of which was previously defined in terms of precious metal. **The standard money made of that metal is then said to be demonetised but it may continue to circulate as Fiduciary Money (It means that Money that depends for its value on confidence that it is an accepted medium of exchange. It originated as a paper certificate that was a promise to pay a certain amount of gold or silver to the bearer. From the Latin fiducia meaning confidence or trust).** This measure is resorted to check black market operation and tax evasion.

- **DEPOSIT INSURANCE AND CREDIT GUARANTEE CORPORATION (DICGC) :** This Corporation was established in January 1962, under the **Deposit Insurance Corporation Act, 1961** for the purpose of providing insurance cover to the bank depositors, particularly small depositors against the risk of loss arising out of bank failures. **All commercial banks including Local Area banks Regional Rural banks are to be registered under the Scheme**. All specified cooperative banks like State cooperative banks and Central cooperative banks come under its ambit. As for the Credit Guarantee Scheme it is optional for the credit institutions. The Credit Guarantee Scheme is intended to provide necessary incentive to banks and financial institutions for giving credit to small borrowers, (including small farmers) to priority sector, to small-scale industries, etc; there is legislative proposal to do away with credit guarantee function of the corporation and to introduce an alternative scheme.

- **DEPRESSION :** Denotes an economic condition characterized by lengthy period of low business activity **when prices remain low, gross domestic product falls, purchasing power is sharply reduced and unemployment is high.**

- **DERIVATIVES:** Financial derivatives are basically **contingent contracts whose values are derived from some underlying financial instruments like currency, bonds, stock indices, and commodities etc,** whose future price movements are uncertain. **Derivatives shift the risk from the buyer of the derivative product to the seller and hence are effective risk management tools.** Derivatives are used to protect assets from erosion in value due to market volatility enhancing income by making a two-way price movement or making quick money by taking advantage of the volatile price movement. The popular derivative products are **forward rate agreement, interest rate futures, interest rate swaps, option contracts etc.**

- **DEVALUATION :** It implies the lowering of the exchange rate of one nation's currency in terms of the currencies of other nations by central bank. **Devaluation is**

introduced for improving relative competitiveness in the international trade. It is resorted to as a corrective action towards solving balance of payment difficulties.

- **DIRECTED LENDINGS: Loans given by banks in accordance with the direction of Government and Reserve Bank is referred to as directed lending**. The objective of directed lending is to canalise credit into areas where it would not have flowed in the normal course and hence it is an institutional correction to direct the credit flow into the desired areas.
- **DISINTERMEDIATION :** Circumvention of the banking system as a source of finance.
- **EASY MONEY POLICY:** As contrasted to tight money policy this refers a policy of the central bank of expanding money supply to reduce interest rates. One purpose of such a policy is to facilitate increase in investment thereby raising gross domestic product.
- **ECONOMIC CAPITAL :** As distinguished from Regulatory capital, the Economic Capital is defined by the **Global Association of Risk Professionals (GARP)** as the **capital cushion required against the underlying credit, market and operational risk exposure of a banking organization. It is called 'economic'' capital** because **it measures risk in terms of economic realities** rather than potentially misleading regulatory or accounting rules.
- **EMERGING MARKET ECONOMIES :** These are countries that are starting to participate globally by implementing reform programmes and undergoing economic improvement. **A term coined in 1981 by Antoine W Van Agtmael of the International Finance Corporation**, an emerging market economy is defined as an economy with low- to- middle per capita income. Such countries constitute approximately 80% of the global population, representing about 20% of the world's economies. EMEs are characterised as transitional, meaning they are in the process of moving from a closed to an open market economy while building accountability within the system. Examples include the former Soviet Union and Eastern Bloc countries.
- **ESCROW ACCOUNT :** Escrow account is an account where the **moneys parked will be released only on fulfilment of some conditions of contract like export taking place or like power fed into the national power grid etc**. (in the case of government getting power from independent power producers). The beneficiary of the account can get the money after fulfilling the prescribed conditions. It is an account placed in trust with a third party, by a borrower for a specific purpose and to be delivered to the borrower only up on the fulfilment of certain conditions.
- **EXCHANGE CONTROL :** Refers to official restrictions, which limit the freedom of residents to buy and sell foreign exchange. The primary aim of exchange control is the conservation of scarce foreign exchange resources. Controls are also used generally to support exchange rate policy. Exchange control helps a country to avoid destabilising capital flows or sharp movements in reserves.

- **EXCHANGE RATE :** This expresses the price of one unit of foreign currency in relation to the domestic currency in a foreign exchange market. The foreign exchange market is a market where currencies of different countries are traded. Under the fixed exchange rate regime where there are fixed par values, exchange rates are reasonably stable. **Central Bank intervention in the forex market is frequent and most of the foreign exchange transactions are in the spot or cash market**. Under the **floating exchange rate system, exchange rates are not determined by Government or Central Bank but by the market forces of supply and demand**. The exchange rates float or freely move up and down. Central Bank intervention in the market becomes less frequent. It intervenes only when devaluation in domestic currency is necessitated due to FOREX market volatility and **to adjust domestic exports on line with Imports or to increase Exports considerably to consolidate domestic currency in long run.**

- **EXCHANGE RATE FORECASTING:** Exchange rate is the price of one currency in terms of another currency. Outside fixed exchange rate system, the rate, like any other market price is determined by the forces of demand and supply. These forces are governed by certain economic variables like trade balances, inflation, interest rate etc. Fundamental approach to forecasting exchange rate depends on forecasts of these key variables. As a rule of thumb method, exchange rate will tend to rise (fall) if (**i) the current account is in surplus (deficit) (ii) inflation relative to other countries is low (high) (iii)interest rate relative to other countries rise (fall).** The capital flows and interplay between market expectations and government policy often render the fundamental approach inadequate.

- **EXCHANGE RATE MANAGEMENT :** One of the responsibilities of the RBI is to ensure the stability of the exchange rate of rupee. **The RBI Act 1934 empowers the RBI to buy from and sell to any authorised person foreign exchange at such rate of exchange and on such terms and conditions that the government may decide.** Presently the RBI announces **a reference rate based on the quotation of a few selected banks in Mumbai at 12 noon every day and buys and sells only U.S. Dollar.** The exchange rate is determined by the supply and demand of the currency. When the demand for currency exceeds supply, the currency becomes dear and vice versa. In order to bring orderly conditions in the market and protect the domestic currency's value, Central Bank intervenes in the market by selling or buying the foreign currency in the market. The objective of the exchange rate management is to ensure that the external value of the rupee is realistic and credible so as to have sustainable balance of payments position and healthy foreign exchange situation.

- **EXPOSURE NORMS :** Refers to the prescription of **limits on exposure with respect to credit (funded or non-funded) and investment to (i) individual/group borrowers in India, (ii) specific industry or sectors and towards unsecured guarantees and unsecured advances.** Exposure limits are also prescribed with regard to advances against shares/debentures. This is intended to attain better risk management and avoidances of concentration of credit risks.

- **EXTERNAL DEBT:** Refers to outstanding contractual liabilities of residents of a country to non-residents in gross terms, involving payment of interest with or without principal or payment of interest principal with or without interest. The debt liabilities consist of long term and short term liabilities and include (i) multilateral government or non-government debt (ii) bilateral government or non-government debt (iii) loans from International Monetary Fund (iv) commercial borrowing (v) NRI deposits and (vi) rupee debt and (vii) trade credit. Contingent external liabilities (like derivatives, letter of credit, guarantees etc) which have the potential of becoming actual liabilities do not form part of the external debt data.
- **FIAT MONEY:** Refers to money, like the currency of the present day, **without intrinsic value but decreed (by fiat) to be legal tender by the Government**. Fiat money is accepted only as long as people have confidence that it will be accepted as medium of exchange.
- **FINANCIAL INCLUSION:** Refers to the delivery of **banking service at an affordable cost to the vast sections of disadvantaged and low income groups of the population.** The purpose of financial inclusion is to provide access to banking, access to affordable credit and access to free information on money matters.
- **FINANCIAL MARKETS :** Financial markets comprise of **financial assets or instruments and financial institutions involved in movements of funds**. The important segments of financial markets are (i) organised credit market dominated by commercial banks, (ii) the money market with call/notice money segments forming a significant portion, (iii) capital market consisting of primary and secondary equity markets and term lending institutions, (iv) debt market dealing in public sector bonds and corporate debentures, (v) gilt edged market dealing in government securities, (vi) housing finance market, (vii) hire purchase, leasing finance and other non-banking financial companies,(viii)insurance market, (ix) informal credit market and (x) foreign exchange market.
- **FINANCIAL SYSTEM :** This consists of **financial institutions, financial instruments and financial markets, providing an effective payments and credit system and channelling of funds from the savers to the investing sectors in the economy. Financial institutions or financial intermediaries mobilise savings of the community** and ensure efficient allocation of these savings to high yielding investment projects so that they can offer attractive and assured returns to savers and this process give rise to money and other various financial assets. Standing at the centre of the financial system, the Reserve Bank's aim is to maintain financial stability in the country as an essential ingredient for healthy, safe and successful economy.
- **FISCAL POLICY:** Refers to **Government's policy towards taxation, public debt, public expenditure, appropriation and similar matters having an effect on the private business and economy of the nation as a whole.** Taxation and public expenditure policies which are at the centre of fiscal policy, are adopted to help dampen the business cycle swings and contribute to the maintenance of growing economy with high employment and price stability. Fiscal policy is often used to

correct the nation's saving investment imbalance and recessionary trends that cannot be managed by monetary policy. **Fiscal policy directly affects the financial resources and purchasing power in the hands of the public and hence is an important determinant of aggregate demand.**

- **FOREIGN EXCHANGE ASSETS OF BANKING SECTOR:** Refers to net foreign exchanges of RBI comprising gold coin and bullion, foreign securities and balances held abroad offset by A/C NO:1 of International Monetary Fund with RBI. **Foreign currency assets of other banks include balances held abroad in Nostro account** etc and investments in eligible foreign securities and bonds less overseas borrowings of banks and **non-resident repatriable foreign currency fixed deposits with banks**
- **FOREIGN EXCHANGE MANAGEMENT ACT (FEMA) :** Replacing the Foreign Exchange Regulation Act (FERA) the Foreign Exchange Management Act was enacted in 1999, the provisions of which are aimed at consolidating and amending the law relating to foreign exchange transactions with a view to facilitate external trade and payments and development of foreign exchange market. This change was brought out in the context of certain developments in the external sector like sizable increase in the foreign exchange reserve, growth in foreign trade, rationalisation of tariffs, current account convertibility, liberalisation of Indian investment abroad, increased access to external borrowings and investment in Indian stock market by foreign institutional investors. While FERA laid stress on conservation of foreign exchange and its proper utilisation, FEMA aims at facilitating external trade and promoting orderly development of forex market. **FERA was a criminal law where as FEMA is a piece of civil law.**
- **FOREIGN EXCHANGE RESERVES OF RBI :** Accretion to the foreign exchange reserves of the RBI comes from purchase of U.S. Dollar from authorised dealers, aid and loan receipts on Government of India account, International Monetary Fund transactions, purchase of foreign currencies from international institutions and foreign central banks, earnings in the form of interest and discount. The outgo will be mainly on account sale of US.Dollar to authorised dealers on account of Bank's intervention in the market and International Monetary Fund transactions. The bank's foreign reserves are held mainly in balances with foreign central banks, overnight investments, investment in treasury bills, fixed deposits with Bank for International Settlements and major foreign commercial banks, Certificates of Deposits issued by the banks and investments in long term securities of foreign governments, **IBRD and Asian Development Bank.**
- **FORWARD EXCHANGE RATE :** A forward exchange rate is a rate of exchange which is fixed immediately, by means of a forward exchange contract, but the exchange transaction to which it is applicable would take place at some future date as agreed upon. **A forward exchange contract is a firm and binding bargain between a bank and its customer, or between two banks, under which one party undertakes to deliver and the other to receive a fixed sum in foreign currency against payment in Indian rupees, on a fixed future date, or between two fixed**

dates, at a pre determined rate fixed at time the contract is made. Forward exchange operations enable the creditor who has to receive payment of his debt, in terms of a foreign currency, at a future date, to know exactly the value of money he has to receive in terms of his own currency. Similarly, it enables a debtor who has to pay certain amount, at some future date, in terms of a foreign currency, to know precisely the probable cost to him in terms of his own currency.

- **FUNDING OF TREASURY BILLS :** Funding of treasury bills denotes a process **where by short-term treasury bills (including ad hoc treasury bills) are converted into long term securities.** This implies extension of the maturity of government debt and results in reduction in the outstanding treasury bills.

- **GENERAL LINE OF CREDIT (GLC):** A General Line of Credit may be defined as an **arrangement in which a bank or a vendor extends a specified amount of unsecured credit to a specified borrower for a specified time period.** For example, RBI extends a GLC to NABARD under section 17(4E) of the RBI Act to enable it to meet the credit requirement of co-operatives and RRBs.

- **GILTS:** Term denotes Government securities like Central Government loans and State Government loans. Include government guaranteed bonds like that of IDBI. **'Gilts' is the short form for gilt-edged securities- so called because they carry no risk.**

- **GOVERNMENT BUDGET-DEFICIT :** Budget deficit broadly represents excess of total expenditures over total receipts with borrowings not included among receipts. The various measures of budget deficit are as follows.

  - **Traditional budget deficit:** Revenue expenditure +capital expenditure +net domestic lending - revenue receipts + foreign borrowings + domestic borrowings excluding treasury bills.
  - **Monetary deficit:** This is measured by the changes in Reserve Bank credit to government represented by total RBI holdings of government securities (dated securities and treasury bills) less central governments deposits with the Reserve Bank.
  - **Gross Fiscal Deficit:** Revenue expenditure +capital expenditure +net domestic lending-revenue receipts +grants (deficit is covered through all borrowings).
  - **Net fiscal deficit:** Gross fiscal deficit -Net domestic lending.
  - **Primary deficit:** gross fiscal deficit -net interest payments, i.e. interest payments -interest earnings
  - **Net primary deficit:** (non-interest revenue expenditure +capital expenditure)-(non-interest revenue receipts +grants). Primary deficit concept indicates the extent to which current fiscal actions affects the debt position of Union Government.

- **GOVERNMENT'S CURRENCY LIABILITIES TO PUBLIC:** Denotes circulation of rupee coins and small coins.
- **GROSS DOMESTIC PRODUCT (GDP) :** Gross Domestic Product is **a measure of the total value of final goods and services produced within a country during a given year**. Gross domestic product can be measured in two different ways **(1) as the flow of final product and (2) as the total cost or earnings of inputs producing output.** Each year public consumes a wide variety of final goods and services. Summation of the value spent on these final goods and services will give the GDP in an over simplified example of calculation. Comprehensive definition of GDP would include all final goods and services, like consumption expenditure, private investment, government spending on goods and services and net exports to the rest of the world. In other words GDP is defined as the total money value of the final products produced by the nation. Intermediate products are excluded. **The second way to calculate GDP is to total the annual flow of factor earnings, wages, interest, rent and profits that are the costs of producing society's final products. This is called the cost or earning approach. Gross National Product (GNP) equals the GDP plus the income accruing to domestic residents less income earned by the foreigners in the domestic economy.**
- **GROUP OF 5 COUNTRIES (G5):** The Group of 5 consists of the members of the International Monetary Fund **whose currencies constitute the Special Drawing Rights: France, Germany, Japan, United Kingdom and United States.**
- **GROUP OF TEN (G10):** The Group of Ten or G10 refers to the group of countries that have agreed to participate in the **General Arrangements to Borrow (GAB).** The GAB was established in 1962, when the governments of eight International Monetary Fund (IMF) members - Belgium, Canada, France, Italy, Japan, the Netherlands, the United Kingdom and the United States - and the Central Banks of two others, Germany and Sweden, agreed to make resources available to the IMF for drawings by participants. and under certain circumstances, for drawings by non participants. The GAB was strengthened in 1964 by the association of Switzerland, then a non member of the Fund, but the name of the G10 remained the same.
- **IMPORT COVER :** Level of a country's international reserves in relation to its average monthly import bill. Three months import cover is regarded as an adequate insurance against severe payment difficulties.
- **IMPOSSIBLE TRINITY :** It stands for theoretical impossibility of having a macroeconomic situation in a country in which all the following three aspects together can coexist, namely (1) pegged exchange rate (2) free capital flows and (3) independent monetary policy. Due to conflicting objectives, an economy cannot achieve monetary independence, exchange rate stability and full financial integration by allowing free capital flows. Free capital flows will affect exchange rates; monetary independence also would affect exchange rates (increase or decrease in domestic money supply will affect exchange rates). Likewise, if a country tries to maintain fixed exchange rate, it has to absorb all the inflows of foreign capital, which in turn

will affect the money supply. This will affect the monetary independence because of disturbance to the monetary policy stance.

- **INDIAN FINANCIAL NET WORK (INFINET) :** This was set up by the Reserve Bank in 1999 through the **Institute for Development and Research in Banking and Technology (IDRBT) Hyderabad.** The purpose is to establish an efficient, safe and dependable communications backbone to cater to the networking requirements of public sector banks and financial institutions. All fund based operations such as electronic fund transfers, centralised fund management scheme, anywhere banking, government securities trading, ATM/Credit transactions, currency chest accounting are done through this.
- **INFLATION :** Inflationary price movement means a rise in the comprehensive price index, say, index of wholesale prices. The implication of inflation is that the value of money tends to grow unstable. The inflationary situation is generally featured by (a) rise in prices and cost of living (b) excess of money supply (c) prevalence of restraints on consumption and (d) administrative controls. The classical type of inflation occurs when the money supply increases faster than the output of goods or services. Yet another type of inflation emerges out of the operation of factors of cost evidenced by a more or less constant rise in cost of production which is passed on to consumers.
- **INFLATION MEASUREMENT:** Inflation rate forms part of important macro economic indicators used by policy makers particularly central bankers in policy formulation. Inflation could be measured through **three sets of price indices namely, the Whole price indices (WPI), implicit National Income Deflator and Consumer Price Indices (CPI).** The WPI is compiled for all commodities as well as major groups and individual commodities and is published on a weekly basis since 1942. Weights are assigned to the commodities/sub-groups/major groups on the basis of the value of the whole sale market transactions at the time of adoption of the base year. The commodities are classified under 3 major groups, (1) **primary articles, (2) fuel, power, light and lubricants and (3) manufactured products.** This index because of the good frequency of availability helps continuous monitoring. The National Income Deflator, a comprehensive index is derived as a ratio of GDP at current prices to GDP in real terms. It encompasses all the economic activities including services. The CPI reflects the retail prices of selected goods in the commodity market of homogeneous group of consumers. Consumer price indices are separately computed for **(1) industrial workers (2) urban non-manual employees and (3) agricultural labourers.** The major groups covered are food, pan supary, tobacco, intoxicants, fuel, housing, clothing, bedding, and footwear and miscellaneous items.
- **INFRASTRUCTURE DEVELOPMENT FINANCE COMPANY (IDFC) :** For the purpose of fostering the growth of private capital flow for infrastructure facilities like power, roads, railways, highways, waterways, irrigation etc, on a commercially viable basis, the IDFC was established in Chennai as a Limited company in January 1997. It acts as a direct lender and a refinancing agency. The Government of India and Reserve Bank hold 40 percent stake in the company. Other institutions who have

participated in the share capital are Industrial Credit and Investment Corporation of India, Unit trust of India and Housing Development Finance Corporation Ltd. The company also promotes debt securitisation and offers credit guarantees.

- **INSTITUTE FOR DEVELOPMENT AND RESEARCH IN BANKING TECHNOLOGY - (IDRBT) :** Set up by RBI at Hyderabad in 1996, the institute is an autonomous centre for development and research in banking technology. This is funded by RBI and is an autonomous centre for promotion of technology solution, adaptation, and absorption of banking technology so as to improve functioning of banking and financial sectors.
- **INTERNAL CAPITAL ADEQUACY ASSESSMENT PROCESS (ICAAP) :** This is intended to ensure that the capital held by the Bank is commensurate with the Bank's overall risk profile. The ICAAP takes into account effectiveness of Bank's risk management system in identifying, assessing, measuring, monitoring and managing various risks. **ICAAP** comprises all of the Bank's procedures and measures designed to ensure:

    a) appropriate definition and measurement of risks and

    b) appropriate level of internal capital in relation to Bank's risk profile.
- **INTERNATIONAL MONETARY FUND (IMF) :** The IMF is an organisation of 184 countries, working to foster global monetary cooperation, secure financial stability, facilitate international trade, promote high employment and sustainable economic growth and reduce poverty. The role of IMF is to ensure **orderly international trade and payments and to** stabilise internal and external imbalances of a country and to improve their balance of payments situation
- **KNOW YOUR CUSTOMER (KYC) :** The object behind introduction of the concept of know your customer is to prevent banks from being used intentionally or unintentionally by criminal elements for money laundering activities. The guidelines used by the RBI in this regard are to help banks to know their customers and their financial dealings better, which may help them, manage their risk effectively. Adherence to proper customer identification procedures, verification of social and financial standing of the customer, monitoring the transactions in the accounts so as to detect any abnormalities and preparation of risk profiles of the customers are the key elements of Know Your Customer policy.
- **LEAD BANK SCHEME :**The scheme is formulated to give shape to the area approach for development. The objective is to bring together concerned institutions like commercial banks, co-operative banks, marketing societies, government departments and state level corporations etc, to formulate and implement a plan for development of banking and extension of credit in each district. Under the scheme various commercial banks have been allotted districts for development. The lead bank will be responsible for identifying centres for branch expansion, prepare branch expansion programme, to survey and identify potential area for development of

agriculture, small scale industries, prepare estimate of the credit requirement of the district and deposit mobilisation etc.

- **LEGAL TENDER :**Denotes money recognised as legally acceptable in payment or on account for (in the absence of contract to the contrary) payment of debts. In a valid tender by a debtor of bank notes which are legal tender in terms of **section 26(1) of RBI ACT 1934**, if the payment is refused by the creditor, the debtor is discharged from further liabilities, while the debt remains.
- **LIQUIDITY ADJUSTMENT FACILITY (LAF) :** LAF is a **monetary policy instrument introduced in 2000 to modulate liquidity in the system in the short term and to send interest rate signals to the market.** LAF operates through **Repo and Reverse Repo transactions**. RBI conducts repo to inject liquidity into the system through purchase of government securities with an agreement to sell them at a predetermined date and repo rate. In the reverse repo transaction RBI sells securities with a view to absorb excess liquidity with a commitment to repurchase them at a predetermined reverse repo date and reverse repo rate. Besides the function of day today liquidity management LAF is increasingly used as instrument of stabilisation. **Other instruments of liquidity management are Open Market Operations (OMO) in the form of outright purchase/sale of securities and Market Stabilisation Scheme (MSS).**
- **LIQUIDITY AGGREGATES :** In order to have an approximate measure of overall liquidity in the economy, wider liquidity measures incorporating the liabilities of non-depository corporations have been evolved. These are:
  - **L1==M3+Postal Deposits** (excluding National Saving Certificate)
  - **L2== L1+Term Money Borrowings, Certificate of Deposits and Term Deposits of Financial** Institutions like IDBI, IFCI, Exim Bank, NABARD, SIDBI etc.
  - **L3== L2+ Public Deposit with non-banking financial institutions.**
- **LONDON INTER BANK OFFERED RATE (LIBOR) :**LIBOR is the most widely used benchmark or reference rate for short term interest rates. It is compiled by the British Bankers' Association (BBA) and released to the market at about 11.00 a.m. each day. LIBOR is the rate of interest at which banks borrow funds from other banks, in marketable size, in the London inter-bank market. **The BBA maintains a reference panel of at least 8 contributor banks**. The BBA surveys the panel's market activity and publishes their market quotes on-screen. The top quartile and bottom quartile market quotes are disregarded and the middle two quartiles are averaged: the resulting "spot fixing" is the BBA LIBOR rate. The quotes from all panel banks are published on-screen to ensure transparency. LIBOR fixings are provided in ten international currencies: Pound Sterling, US Dollar, Japanese Yen, Swiss Franc, Canadian Dollar, Australian Dollar, Euro, Danish Kroner, Swedish Kronor and New Zealand Dollar.
- **MANAGED EXCHANGE RATES :** Refers to a **hybrid of fixed and floating exchange rates**. In this system the exchange rates are basically determined by market

forces but the monetary authorities sometimes fix target zones or targets and influence the exchange rates by selling or buying currencies or changes in the monitory policies.

- **MANAGEMENT OF EXCHANGE RESERVES: The official external reserves of the country consists of monetary gold and foreign assets of the Reserve Bank besides the holdings of Special Drawing Rights(SDRs).** The Reserve Bank, as the custodian of the country's foreign exchange reserves, is vested with the duty of managing the investment and utilisation of the reserves in the most advantageous manner. Having regard to the safety and liquidity, the objective of reserve management is to preserve real value and get reasonable level of return.

- **MARKET STABILISATION SCHEME (MSS) :** The Reserve Bank has been usually utilising its investment in government securities for conducting open market operations, repo and reverse repo transactions. With the increased inflow of foreign exchange and the consequent monetary expansion it becomes necessary for RBI to sterilise the monetary impact by mopping up excess liquidity through open market operations. This invariably resulted in **depletion of the RBI holding of government securities** hampering the control of sterilisation operation. Hence a new scheme called the **Market Stabilisation Scheme** was introduced in 2004. Under this scheme, Government would issue **Treasury Bills and Dated Securities to the RBI for absorbing liquidity in the system. Government's cash balances with the RBI** would go up correspondingly. **The government cannot withdraw the amount, which is held in a separate identifiable cash account with RBI. Securities obtained under the MSS are auctioned by the RBI and the proceeds kept in separate MSS account maintained and operated by RBI.** The proceeds kept in the MSS account will be utilised only for redemption of treasury bills and securities.

- **MARKING TO MARKET :** This is the practice where by the **banks are required to value their investment at lower of cost or market value, so that bank's balance sheet presents a realistic picture of the financial health.**

- **MICRO FINANCE :** The term refers to low value financial services extended by the financial institutions to the poor people. The services broadly include provision for savings, credit, insurance, leasing, money transfer etc to poor and low-income households and their micro enterprises. In India savings and credit aspects of the micro finance have been accorded due consideration so far.

- **MONETARY AGGREGATES:** Money for policy purposes is defined to include a set of liquid financial assets, which have an impact on the aggregate economic activity. On the basis of two important functions of money viz, medium of exchange and a store of value, the following monetary aggregates have been formulated for monitoring the state of liquidity in the economy. They are arrived at by consolidation of balance sheet of the banking system.

    - **M0==**Currency in circulation +bankers deposits with the RBI+ other deposits with RBI.

- ★ **M1==**Currency with public + Current deposits with banks + Demand liability portion of savings deposits with the banks + "other deposits" with RBI (deposits of quasi government and other financial institution of foreign central banks, provident and gratuity funds etc).
- ★ **M2==** M1 + Time liabilities portion of savings deposits with banks + certificate of deposits issued by banks + term deposits (excluding FCNR (B) deposits) with banks maturing within one year.
- ★ **M3==** M2+ Term deposits with banks [excluding FCNR (B)] with maturity period exceeding one year + Call borrowings from non -depository financial corporations by the banking system.

MONETARY BASE : Monetary base or high-powered money or reserve money or primary money derives the name from its quality or capacity to serve as a reserve base for creation of deposits, a component of money supply, under the fractional reserve system. Its components are **(a) currency with the public (b) bank reserves comprising balances of commercial and cooperative banks with the RBI and cash on hand with banks and (c) other deposits with RBI.**

MONETARY DEEPENING: Refers to a phenomenon where there occurs a gradual rise in the amount of money in circulation in real terms per unit of output or in the ratio of money supply in real terms to real output. The greater the extent of monetary deepening that occurs in the economy the lower will be the inflationary potential of a given increase in money supply.

MONETARY POLICY : Refers to the use of official policy instruments, under the control of the Central Bank to regulate the availability, cost and use of money and credit with the aim of attaining optimum level of output and employment, price stability, healthy balance of payment position and any other goals set by the government. In an expansionary monetary policy, money supply increases causing an expansion in aggregate demand through lower interest rates.**This stimulates interest sensitive spending on investment for manufacture of goods, housing, export, business etc. and in turn, acting through multiplier leads to a rise in gross domestic product**. The reverse process takes place when monetary policy is tightened. However, in a fully employed economy monetary expansion would primarily raise prices and nominal gross domestic product with little effect on real GDP as the higher stock of money would be chasing the same amount of output.

MONETARY POLICY LAGS : Two types of lags are identified. Inside lag and outside lag. Inside lag refers to the lag within the central bank between the time action is needed and the time, action is actually taken**. The outside lag refers to the lag between the change in rate of interest and availability of credit** and the initial impact on real variables like output and prices. Inside lag could be broken up into the recognition lag and the decision or action lag. The recognition lag represents the lag between the time action is needed and the time the need is recognised by the central bank. The decision lag refers to the lapse of time between the recognition of the need for change in policy and taking of action.

- **MONETARY POLICY STRATEGIES : Monetary policy aims at price stability, provision of appropriate credit for productive activities and financial stability.** There are dilemmas involved in achieving these policy objectives. While providing adequate credit to government and commercial sector, it is to be ensured that inflationary pressures do not build up. Also there is a need to balance the interest cost on public debt with that of commercial credit. In addition, with the liberalisation it becomes necessary at times to tighten monetary policy to avoid speculative pressure on exchange rate. Lastly, in the pursuit of price stability RBI has to look into the aspect of adverse effects of policy actions on balance sheet of the banking system. **The process of monetary policy formulation is essentially based on the information of the entire domestic economy as well as developments in international economy.** An in-house **financial market committee (FMC)** set up in 1997 monitors market development and recommends tactical operation to meet development on a day to day basis. Inflation and GDP growth forecasts are provided by an inter-departmental expert group. **The Board of Financial Supervision** set up in 1994, under the **Bank's Central Board** is entrusted with the oversight of supervision of commercial and selected cooperative banks and financial institutions and non-banking financial companies. The bank also gets policy advice from technical and Advisory committee on Money and Government Securities Markets, Standing Committee on Financial regulation and other expert working groups.
- **MONETARY POLICY TARGETS : The objects of monetary policies are price stability (low and stable inflation) economic growth (stabilisation of output around its potential) and financial stability.** These are called **final targets and are not under direct control of the Central Bank.** For example, monetary policy affects inflation not directly but through impacting the aggregate demand in the economy. Therefore, the Central Bank adopts intermediate targets or operating targets for policy which have a stable relationship with the ultimate macro-economic objectives of monetary policy. These intermediate targets could be interest rates, money supply, credit targets etc.
- **MONERARY TARGETING :** It is defined as an official commitment to **pursue policies to contain the growth of one or more monetary aggregates (M1 or M3) to a particular rate or within a range of growth rate**. It implicitly involves acceptances of some obligations by the monetary authorities to conduct open market operation, constrain government deficit and allow adjustment of interest rates and exchange rates so as to achieve the announced target.
- **MONETARY TRANSMISSION :** Refers to the **process through which changes in monetary policy instruments affect the rest of the economy, particularly output and inflation**. Monetary policy actions are transmitted to the rest of the economy through changes in financial prices such as interest rates, exchange rates, yields, asset prices, equity prices and financial quantities like money supply, credit aggregates etc.
- **MONEY MARKET :** Money Market is a market **where short- term funds are lent or borrowed.** It is a centre for meeting the short-term requirements of borrowers. It is

in money market that the central bank comes into contact with the financial sector of the economy as a whole and by influencing the cost and availability of credit, the Bank achieves monetary policy objectives. **The RBI is a key constituent of the money market being the residual source of supply of funds.**

- **MONEY MARKET MUTUAL FUNDS (MMMFs) :** Represent a **short term investment avenue for retail investors, which lies between low bank deposits and higher money market rates.** One object is to bring money market instruments within the reach of individuals. RBI regulations permit only banks, financial institutions and their subsidiaries to set up **MMMFs. The minimum and maximum size of MMMFs** has been specified and only individuals were allowed to invest. The money market instruments and the investment limits for each were also specified. MMMFs come under the regulatory oversight of SEBI and governed by SEBI (Mutual Funds) Regulation 1996.

- **MONEY MULTIPLIER :** This expresses the relationship between money supply and reserve money and is a measure that explains the variations in money supply with reference to given quantum of reserve money.

- **MORAL SUASION :** Moral suasion is an instrument of monetary regulation whereby the Central Bank seeks to influence the volume and direction of flow of credit by appeal or persuasion to comply voluntarily with its various guidelines to the banks. **Moral suasion may be used in the form of advice on the desirable expansion of bank credit, loan priorities or maintenance of liquid assets etc**

- **MULTIPLE INDICATOR APPROACH (MIA) :** From mid 1980s to 1997-98, the operating method of monetary policy followed by the RBI was **'monetary targeting with feedbacks'**. A crucial assumption of the above framework of monetary policy was the stable relationship between money, output and prices - the money demand function. The above operating method was reviewed in view of the following two major developments: i) liberalistion of financial markets and opening up of the economy and ii) short-term deviation in the relationship between money, output and prices. Over time, it became apparent that besides real income, interest rate also influences the decision to hold money. Hence, from 1998-99 onwards, RBI has been following **Multiple Indicator Approach (MIA), in which a number of macroeconomic and financial variables are considered while deciding the monetary policy rather than a single M3 aggregate as in the past.** Other variables considered are interest rates, rate of return in different markets, bank credit, fiscal position, foreign trade, capital flows, exchange rate, foreign exchange position, etc. Thus, the exclusive use of broad money as an intermediate target was de-emphasised, but the growth in **broad money (M3) continues to be used as an important indicator of monetary policy.** The multiple indicator approach provided necessary flexibility to RBI to respond to changes in domestic and international economic and financial market conditions more effectively.

- **NATIONAL PRODUCT or NATIONAL INCOME : This is an indicator of economic perfomance of a country in any given period and is the measure of**

product generated in a country and income accrued from abroad. (National income = Net national product at factor cost = Sum of all the factor payments (wages, salaries, rent, interest, and profit) = The value of all final goods and services, sold/ produced in the economy as whole. Gross national product - depreciation or capital consumption = Net national product at factor cost. Net national product at factor cost + indirect taxes- subsidies = Net national product at market prices.

- **NARASIMHAM COMMITTEE :** A Committee on Financial System under the chairmanship of M. Narasimham was set up by the Government of India to examine all aspects relating to the structure, organisation, functions and procedures of the financial system and make recommendations with a view to remove the rigidities and weaknesses of the financial system The Committees' recommendations made in November 1991 constitute a landmark in the Banking policy in the country and ushered the banking business into a market oriented system. The RBI has been implementing the key recommendations of the committee since January 1992, which encompassed modifying the policy framework, improving the financial soundness of banks, strengthening institutional framework and strengthening of supervisory mechanism. A second high-level committee on banking sector reforms under the chairmanship of M. Narasimham was appointed by the Government in 1997, to review the record of implementation of financial sector reforms recommended by the first committee and to chart the reforms necessary in the years ahead. The Committee in its report submitted in April 1998 gave wide ranging recommendations to strengthen the banking system and revamp the regulatory and supervisory functions.
- **NEGOTIATED DEALING SYSTEM (NDS) :** NDS,operationalised from February 15, 2002 is a versatile trading platform enabling the market players like banks, insurance companies, mutual funds to trade in securities, in both through computer mechanism or chat mode for negotiation on the system itself. **One important feature of NDS is that it facilitates price-discovery and volume discovery in the government securities market by means of information dissemination in real-time both to market as well as non-market participants.** NDS can also be used by members (banks, primary dealers, financial institutions) to report their secondary market transactions in government securities and money market transactions which have been finalised outside NDS The transactions of members in government securities reported through NDS will be taken up for settlement **(routed through the Clearing Corporation of India Limited) at RBI.**
- **NOMINAL EFFECTIVE EXCHANGE RATE (NEER) :** The multilateral effective exchange rate or trade weighted exchange rate (NEER) is an index number (expressed with a base of 100) of trade weighted nominal exchange rate with respect to a basket of currencies of countries with which the country trades. In other words NEER is the weighted geometric average of bilateral nominal exchange rates of the domestic currency in terms foreign currencies. The weights are normally determined on the basis of country's bilateral trade (exports plus imports) during a chosen period; the weights reflect the importance of other currencies in the home country's total

international trade, and helps to ascertain the exchange rate trends of the domestic currency vis-a-vis those of the major trading partners

- **NON-BANKING FINANCIAL COMPANIES (NBFCs) :** An NBFC is an institution which is **incorporated under the Companies Act engaged in financial activity like granting of loans and advances, acquisition of shares, leasing, hire purchase, conduct of chit funds etc, and whose principal business should not be agricultural operation, industrial activity, trading or real estate business.** The NBFCs are now classified into different categories based on their principal business like, **equipment leasing, hire purchase financing, loans company, investment company, housing finance company, etc.**

- **NON-MONETARY LIABILITIES OF BANKS : Refer to a source of change in money supply.** So named because an addition to these liabilities will have an opposite impact on monetary expansion, unlike the other sources of change which exert positive influence. The net non-monetary liabilities of RBI include paid-up capital and reserves, contingency reserves, exchange fluctuation reserves, RBI employees pension, Provident /guarantee fund, bills payable, other liabilities, IMF a/c no:1 offset by changes in other assets such as premises, loans to staff, debit balances under various heads of accounts, excluding gold held in Banking Department. Net non-monetary liabilities of other banks comprise paid-up capital and reserves, and other net residual items. The net non-monetary liabilities are broadly grouped into **"capital account" and "other items (net)" in the presentation of monetary statistics.**

- **NON-PERFORMING ASSETS (NPA) :** NPA is defined as a credit facility in respect of which interest or instalment of principal has remained unpaid for a specified period during the year. The banks are not allowed to charge and take to income account the income on all non- performing assets.

- **NOSTRO ACCOUNT :** Literal meaning of **nostro account is "our account with you".** Nostro is derived from the Latin term "ours" An account that a bank holds with a foreign bank. These are the accounts opened by banks in India either with their own branches at overseas centres or with any other banks. These accounts are foreign currency accounts. Eg. SBI, Mumbai opens a US. Dollar account with a bank in New York. This is the Nostro account of SBI in US dollar. Similarly, banks can open Nostro accounts in different currencies viz. Pound sterling, Euro, Yen etc., with banks at respective countries.

- **NOTE REFUND RULES:** The RBI Act 1935 lays down that the bank may with previous sanction of the Central Government refund the value of any soiled, mutilated, defaced or imperfect notes. The rules framed under the provision of the act for refunding mutilated, lost or defaced notes and passed by the Central Board of Directors of RBI with the previous approval of Central Government, are known as Note Refund Rules.

- **OFF-SHORE BANKING UNITS:** With a view to providing an internationally competitive and hassle-free environment for production for exports the Government of India introduced **Special Economic Zones (SEZs).** The Government of India also permitted to set up off-shore banking units in these zones. These units are virtually foreign branches of Indian banks but located in India. All banks operating in India authorised to deal in foreign exchange are allowed to open off-shore banking units. The Reserve bank grants exemption from Cash Reserve Ratio requirement to the parent bank in respect of these branches. **Banks, however, have to keep Statutory Liquidity Ratio for the branches**. The sources for raising foreign currency funds are external. Deployment of funds restricted to lending to units located in SEZs and SEZ developers. **The branches are not allowed to deal in Indian rupee.**

- **OFF-SITE MONITORING AND SURVEILLANCE (OSMOS) :** This system providing on-going monitoring of performance of banks was introduced in 1995 with the aim of assessing the financial position of banks between the periods of on-site inspection. Under these **banks are required to submit periodical returns to the RBI incorporating data on assets, liabilities, interest rate and liquidity risk, off-balance sheet exposure etc.** The exercise involves two-tier approaches (1) analysis of statistical reports and (2) routine discussions with management.
- **OPEN MARKET OPERATION (OMO): A monetary policy instrument** which is used by the Reserve Bank mainly **with a view to affect the reserve base of the banks and thereby the extent of monetary expansion.** It also, in the process, helps to create and maintain a desired pattern of yield on government securities and to assist the government in raising resources from the capital market. Under the RBI Act, the RBI is authorised to purchase and sell the securities of the Union Government and State Governments of any maturity and the security specified by the Central Government on the recommendation of Bank's Central Board. Presently the RBI deals only in the securities issued by the Union Government. Open market operations are by way outright sale and purchase of securities through the Securities Department and repo and reverse repo transactions.
- **PARTICIPATION CERTIFICATE (PCs) :** The PCs were introduced in 1969 with a basic **idea that it would even out the liquidity pressure within money market.** This is an instrument which enables a bank to sell to a third party (the transferee) a part or all of an advance made by it to a borrower or client against hypothecation of goods or book-debt. Legally speaking the PC is a deed of transfer. The PC in practice represented a borrower-lender relationship between the PC issuer and the banks /institutions purchasing it. The issuing bank is bound to repay the purchaser bank or participant on maturity irrespective of the position of borrower mentioned in the certificate. **There are two types of inter-bank participations: one on risk sharing basis and the other without risk sharing. The maximum amount for which inter-bank participation would be issued is restricted to 40 percent of outstanding advances. Inter-bank participations with sharing is exempted from Statutory Liquidity Ratio and Cash Reserve Ratio.**
- **PARTICIPATORY NOTES (PNs): These are derivative instruments issued by registered Foreign Institutional Investors (FII) to their clients, who are not directly allowed to buy or sell in Indian markets.** Participatory notes are like

contract notes and are issued by foreign institutional investors to their overseas clients who may not be eligible to invest in Indian stock market. Foreign institutional investors invest funds on behalf of such investors, who prefer to avoid making disclosures required by various regulators. These clients could be high net worth non-resident individual or **Overseas Corporate Bodies or other unregistered units (in India).** FIIs use their client's money to buy or sell stocks in Indian market. Returns for clients depend on the gains/loss made by these registered FIIs from Indian markets.

- **PERPETUAL DEBT:** To enhance the capital raising options of banks, Reserve Bank of India allows banks to raise Innovative **Perpetual Debt Instruments (IPDI), which will be eligible for inclusion as Tier I capital.** Such debt will not have any maturity date, i.e. will be perpetual like equity shares. Claims of investors in Perpetual Debt shall be superior to that of equity share investors and subordinated to that of all other investors. **Quantum of Perpetual Debt is restricted to 15% of total Tier I capital.**
- **POVERTY LINE:** The poverty line, a measure of poverty is fixed in terms of consumption expenditure (per capita monthly consumption expenditure of Rs 49.1 for rural area and Rs 56.6 for urban area at 1973-74 prices or Rs 329.1 and Rs 455.2 monthly per capita expenditure in 1999-2000) at which the norm of adequate nutrition intake (2250 kilocalories per person per day in urban area and 2400 kilocalories per person in rural areas) is realised.
- **PRIMARY DEALERS: (PDs)** In India the primary dealer system was set up in 1995 to strengthen and develop the government securities market and enhance the efficiency of open market operation. Primary dealers can be subsidiaries of scheduled commercial banks, or all India financial institutions or companies under the companies act 1956 engaged predominantly in government securities market and subsidiaries of foreign banks or securities firms. **Every PD has to maintain minimum net owned funds of Rs 50 crores** deployed daily in the government securities market. They are subjected to certain obligations with regard to bidding, turnover, commitments etc. RBI provides liquidity support to PDs against central government securities.
- **PRIORITY SECTOR ADVANCES :** Priority Sector advances broadly comprise advances to agriculture, (both direct and indirect) small scale industries, other activities/ borrowers, such as small business, retail trade, small road and water transport operators, professionals and self employed persons, housing and educational loans, micro credit to self help groups, consumption loans, small loans to software and food processing sector.
- **PUBLIC DEBT :** Refers to the **means by which the government raises resources for financing public expenditure by issuing government securities both long term and short term securities** like treasury bills. Internal debt of the Central government includes loans floated on the market, bonds such as prize bonds, bank compensation bonds, treasurry bills and non-negotiable non interest-bearing securities issued to international financial institutions like IMF, IBRD. Apart from this there are "other liabilities" of the Union Government, comprising small savings, state provident funds,

postal insurance and life annuity fund etc. These liabilities are also to be serviced through interest payments and redemption on maturity. Government securities are in the form of government promissory notes or in the form of stock certificates. **Government promissory note is a negotiable instrument and transferable by endorsement and delivery**. Stock can be in the form of **book debt which could be held in the form of stock certificate or an account called subsidiary general ledger account**. **Stock certificate is not negotiable but transferable by execution of transfer deed and registration of change in the name in the books of Public Debt Office of RBI. Thus, public debt consists of total value of accumulated borrowings by the government from the public-households, banks, and financial institutions and others.**

- **PURCHASING POWER PARITY (PPP) :** The basic proposition of PPP is **that identical goods must sell at identical prices in a competitive market place.** Otherwise, **there will be opportunities for arbitrage. Competition will tend to equalise the price of identical basket of goods in domestic and foreign markets, through movements in exchange rate or through competitive bidding of the price of the commodities.** Under PPP, exchange rate is in equilibrium when it equalises the prices of basket of similar goods and services in two countries. **The PPP in other words is the ratio of the level of prices abroad to the level of home prices. This measurement called absolute PPP does not often hold true because of quality differences, transportation costs, and other tariffs** etc

- **QUANTITATIVE CREDIT CEILING: A tool of credit policy, this involves fixation by the RBI of limits on the extension of non-food bank credit or on the incremental non-food credit-deposit ratio.** One rationale of credit ceiling is that while expansion in the aggregate credit should be restrained to a specific amount, individual productive and priority sectors should be assured of adequate credit of an increasing percentage of the incremental growth in credit.

- **QUASI FISCAL COST OF RESERVES: Difference between the interest rate on domestic securities and the rate of return earned on the foreign exchange reserves (adjusted for any exchange rate change).** This is called **'quasi-fiscal costs'** since the central bank transfers the costs to the sovereign in the form of a reduced surplus.

- **REAL EFFECTIVE EXCHANGE RATE (REER) :** The multilateral trade **weighted real effective exchange rate (REER) is a weighted average of real exchange rate in respect of basket of countries with which the country trades**; **the real exchange rate is obtained by deflating the nominal exchange rates with the relative price differential between the domestic and foreign countries.** Thus **REER** is the weighted average of NEER adjusted by the ratio of domestic price to foreign prices. **It is one of the most commonly used indicators of international competitiveness. RECESSION :** Refers to business condition with mild tapering off of economic activity not qualifying to be called phase of depression. The text book definition of recession is two consecutive quarters of declining out put. Recession can also be used to describe any period in which growth falls below an economy's trend growth rate.

- **REGULATION :** Regulation refers to codification of sound principles, norms and practices in relation to financial institutions or banks.
- **REGULATORY CAPITAL :** As per the Basel Accord Regulatory Capital refers to the minimum capital required to be maintained by the **bank (regulatory minima) against its risk weighted assets as defined** in the 1988 capital accord with subsequent amendments and prescribed by the national supervisor.
- **REPO (REPURCHASE OBLIGATION) :** The Reserve Bank manages day to day liquidity or short term mismatches under different financial market conditions through repo and reverse repo auctions. This, in addition to bringing in stable condition in the money market, sets the pace for short term interest rate. Repo involves two legs of transactions. In the first leg RBI buys securities and injects liquidity by paying cash to the seller. In the second leg RBI releases securities against receipt of money from the counter party. Repo provides a collateralised-funding alternative. The RBI has enabled NBFCs, mutual funds, housing finance companies and insurance companies to undertake repo transactions, through gilt accounts maintained with the custodians.
- **REVERSE REPO :** This is opposite of the repo transaction. In the first leg RBI sells securities and absorbs liquidity. In the second leg RBI buys back the securities and releases value equivalent to the amount given in the first leg plus interest at reverse repo rate on the amount given in the first leg. This instrument is used for absorbing liquidity from the system for short periods.
- **RISK ASSET RATIO: In 1988 Basel Committee on Banking Supervision prescribed a common minimum capital standard to banking industry of group of 10 countries (G-10)** in the context of the need for management of cross border capital flows following oil crisis and international debt crisis. In the adoption of Basel Committee frame work on capital adequacy norms taking into account various element of risks, the RBI decided to introduce a Risk Asset Ratio system for banks in India as a capital adequacy measure.**In this system, the balance sheet assets, non-funded items and other off-balance sheet exposures are assigned weights according to perceived risks.** Banks have to maintain **unimpaired minimum capital funds equivalent to prescribed ratio on the aggregate of risks weighted assets and other exposures continuously. The ratio of capital to risk weighted assets is known as CRAR.**
- **RISK ADJUSTED RETURN ON CAPITAL (RAROC) : An approach to relate the return on capital to the riskiness of the investment.** Using a **hurdle rate (i.e. expected rate of return) a lender can use the RAROC principle** to set the target price of a transaction**. Risk Adjusted Return on Capital (RARCO) is a concept used in Credit Risk management and is a risk based** profitability measurement for analysing risk-adjusted financial performance and providing a consistent view of profitability across portfolios. It is defined as the ratio of risk adjusted return to economic capital or Return on Capital adjusted for expected losses.

- **RISK BASED SUPERVISION (RBS):** This exercise essentially involves continuous monitoring and evaluation of risk profiles of the supervised institutions in relation to their business strategy and exposures. The basis of the instruments of RBS will be the supervisory tools used for on-site examination and off-site monitoring under the CAMELS. Risk assessment of the bank is carried out before the on-site inspection process. The strengths and vulnerabilities are identified on an on-going basis. A bank specific supervisory programme is drawn up on the basis of inputs gathered with the help of supervised bank. The periodicity of the inspection is determined having regard to the risk profile of the bank and it covers all identified high- risk areas.
- **SAVING : Saving is that part of the disposable income which is not consumed**. It amounts to **accumulation of wealth through postponement of consumption. Saving and capital formation** play a crucial role in economic development. **For estimation of domestic saving, the economy is divided into three sectors; the public sector, the private corporate sector (organized sector) and the household sector (unorganized sector).** Household sector consists of farm households, unincorporated enterprises engaged in industry, trade, finance, transport etc; charitable trusts and household proper. Public sector savings represent savings of Government administration, departmental commercial enterprises, and non-departmental non-financial and financial enterprises. **Savings of household sector, which account for more than 2/3 of gross domestic savings in the country, are in the form of financial assets like currency, bank deposits, life insurance funds, provident funds, investment in shares/debentures, small savings etc;** and **physical assets such as investments in machinery and equipment, investment in agriculture, non-farm business and inventories held by household sector. The rate of saving is measured as the proportion of gross domestic savings to Gross Domestic Product. Income and interest rates are the major determinants of rate of saving.**
- **SCHEDULED BANKS :** Banks in the country are broadly classified as scheduled banks and non- scheduled banks. **A scheduled bank, which could be either cooperative bank or commercial bank, is one which has been included in the Second schedule of the Reserve Bank of India Act.** These banks are eligible for certain facilities such as financial accommodation from RBI and are required to fulfil certain statutory obligation. The RBI is empowered to exclude any bank from the schedule whose (1) aggregate value of paid up capital and reserves fall below Rs 5 lakh (2) affairs are conducted in a manner detrimental to the interests of depositors and (3) goes into liquidation and ceases to transact banking business.
- **SECURITISATION AND RECONSTRUCTION OF FINANCIAL ASSETS :** The government of India enacted the Securitisation and Reconstruction of Financial Assets and Enforcement of Security Interest Act in 2002 to provide among other things, for enforcement of security interest for realisation of dues without the interventions of courts and tribunals. Secured creditors are enabled to authorise their officials to enforce the securities and recover the dues from the borrowers. **Since the Act provides for sale of financial assets by banks and financial institution to securitisation companies (SCs) or reconstruction companies (RCs) guidelines**

have been issued to ensure that the process of asset reconstruction proceeds on sound lines.

- **SEIGNIORAGE: Net revenue gained from the issuing of currency and coins.** It arises from the difference between the face value of a currency note and the cost of producing, distributing and eventually withdrawing it from circulation.
- **SELECTIVE CREDIT CONTROL :** Selective credit control, as distinguished from general credit control is operated to ensure an adequate credit flow to the desired sectors while preventing excessive credit for less essential economic activities. The techniques of selective credit control involves prescribing (**1) minimum margin for lending against the value of specified securities (2) ceiling on the level of credit and (3) minimum rate of interest on advances.** Selective credit control is usually applied to achieve a reduction in excessive advances against certain sensitive commodities in short supply and to reduce pressure on demand supported by bank credit.
- **SERVICE AREA APPROACH (SAA) : The Scheme was introduced in April 1989 with a view to bringing about an orderly and planned development of rural and semi-urban areas of the country.** Under the scheme all rural and semi-urban branches of banks were allotted specific villages generally geographically contiguous areas with the responsibility to take care of the overall development and the credit needs. The Scheme involves credit planning and monitoring of credit utilisation and enables rural borrowers to have easy access to credit from any bank of their choice at a competitive price.
- **SHREDDING AND BRIQUETTING SYSTEM: A system for destruction of unusable notes at the RBI.** The system cuts the notes into small pieces and then converts them into fine shreds. These shreds are then automatically channelled into the briquetting system which compresses them under high pressure resulting into formation of briquettes.
- **SMALL COIN DEPOT :** Small coin depots of the Government of India have been established at important branches of commercial banks and treasuries to facilitate distribution of small coins (paise 50 and below). RBI makes arrangements to keep adequate stock of coins at these depots so as to enable the treasury/bank to meet the demand for small coins. Surplus balances of coins are put back to the depots. Any withdrawal from or deposit into a depot is required to be reported to RBI where adjustments are made to the credit or debit to the government.
- **SOCIETY FOR WORLD-WIDE INTER-BANK FINANCIAL TELECOMMUNICATION (SWIFT) :** Stands for international computerised telecommunication network headquartered at La Hulpe, Belgium. It was operationalised in 1977 and operates from more than 100 countries. There are over 4000 member banks. India became a SWIFT member in 1991. Each bank is given a unique code by SWIFT.

- **SPECIAL DRAWING RIGHTS (SDRs) :** The scheme of Special Drawing Rights was devised by the International Monetary Fund in 1969 which provides additional means of international settlement, to the member countries of the Fund. **The SDRs are created to generate international liquidity on the basis of deliberate judgement of global need for international reserves. They provide unconditional liquidity since the participants have access to foreign exchange reserves at will. SDRs are intended to supplement gold and carry an absolute gold value guarantee.** They cannot be traded in any foreign exchange market but are freely tradable between central banks for acquiring foreign currencies. The participants are obliged to provide their own currencies in exchange of SDRs offered by other participants up to a prescribed limit. SDRs can be used only for balance of payment requirements and not for changing the composition of reserves. SDRs form part of the total foreign exchange reserves of the country.
- **STATUTORY LIQUIDITY RATIO (SLR) :** Under the provision of Banking Regulation Act governing the banking operations, banks are required to hold liquid assets such as government securities, or other unencumbered approved securities, cash or gold, against their **demand and time liabilities in India. This is known as supplementary reserve requirement or secondary reserve requirement**. The main objective of this monetary policy instrument is to ensure solvency of commercial banks by compelling them to hold low risk assets up to a stipulated extent. It also helps to regulate the pace of credit expansion to commercial sector. SLR refers to the ratio of holdings of the prescribed liquid assets to total time and demand liabilities.
- **STERILISATION : Denotes the process whereby the monetary impact of the liquidity generated by accretion to the foreign exchange assets of RBI is neutralised through the use of open market operation(OMO) or liquidity adjustment facility(LAF) or cash reserve ratio(CRR)**
- **TAX HAVEN :** An offshore financial centre having legal mechanisms to reduce or eliminate taxes on income, wealth, profits and inheritance or to accumulate tax free income offshore pending repatriation to a taxable jurisdiction.
- **TIGHT MONEY POLICY :** Refers to the monetary policy of restraining or reducing the money supply and of raising interest rates. This policy may have the effect of slowing the GDP growth, reducing the rate of inflation or raising the nation's foreign exchange rates.

  TREASURY BILLS : These bills are the main **instrument of short-term borrowing by the government and serve as convenient gilt edged security for the money market. The Reserve Bank, as an agent of the government, sells treasury bills at a "discount".** The difference between the amount paid by the tenderer at the time of purchase (less than face value) and the amount received on maturity represent the amount of interest and known as discount. These are negotiable securities and can be rediscounted with the Reserve Bank at any time before maturity upon terms and conditions prescribed by the bank. Presently treasury bills of 91days and 364 days of maturity are sold through weekly auctions.

- **UNIVERSAL BANKING :** The term universal banking in general refers to the combination of commercial banking and investment banking i.e. issuing, underwriting, investing and trading in securities. However, in a very broad sense the term refers to providing a wide variety of financial services under a single umbrella. Universal banking can be defined as the conduct of a range of financial services comprising deposit taking and lending, trading of financial instruments and foreign exchange, underwriting of new debt and equity issues, brokerage, investment management and insurance.
- **VALUE DATE :** Denotes maturity date of a spot or forward contract
- **VARIABLE RESERVE RATIO : An important monetary policy instrument and refers to the Cash Reserve Ratio (CRR) to be maintained by the banks under the provision of RBI Act 1934 and Statutory Liquidity Ratio (SLR)** as defined under the Banking Regulation Act 1947.
- **VELOCITY OF CIRCULATION OF MONEY :** An important aspect of money like the quantity is its velocity which refers to the number of times money is used to buy final output of goods and services. It measures the rapidity with which money changes hands and circulating through the economy during a given period. Income velocity, that is payment for goods and services, is usually measured by dividing national income at current prices for a given year by the sum of total money in circulation.
- **VOSTRO ACCOUNT :** Vostro **account means "your account with me". The counterpart to nostro account is vostro (Latin "yours")** which describes the record of an account held by a bank as correspondent on behalf of an overseas bank. These are the accounts opened by banks abroad with the banks in India. They are rupee accounts.
- **WAYS AND MEANS ADVANCES (WMA) :** Under the RBI Act the **Reserve Bank provides Ways and Means Advances to the State Governments to help tide over the temporary mismatches in the cash flow of their receipts and payments.** While normal WMAs are clean advances, special WMAs are secured advances provided against the security of Government of India dated securities. The normal WMAs are revised every year. **No state government is allowed to have an over draft position for more than a stipulated number of working days**. If the overdraft persists beyond the stipulated period the RBI suspends the payments. The interest rate on WMA has been linked to repo rate. Since the abolition of the automatic creation of ad-hoc treasury bills in 1997 a system of ways and means advances to the Union Government was introduced to meet the temporary mismatch between the receipts and payments of Union Government. **These loans are repayable within three months from the date the advance in terms** of the Central government's agreement with RBI in respect of the maximum amount and rate of interest.
- **WORLD BANK :** It is one of the United Nations' specialised agencies, comprising 185 member countries. The "World Bank" is the name that has come to be used for the **International Bank for Reconstruction and Development (IBRD) and the**

International Development Association (IDA) These organisations provide low-interest loans, interest free credit, and grants to developing countries. In addition to IBRD and IDA, three other organisations make up the World Bank Group. **The International Finance Corporation (IFC) promotes private sector investment by supporting high-risk sectors and countries. The Multilateral Investment Guarantee Agency (MIGA)** provides political risk insurance (guarantees) to investors in and lenders to developing countries. And the **International Centre for Settlement of Investment Disputes (ICSID)** settles investment disputes between foreign investors and their host countries. The World Bank Group's mission is to fight poverty and improve the living standards of people in the developing world. It is a development Bank which provides loans, policy advice, technical assistance and knowledge sharing services to low and middle income countries to reduce poverty. The Bank promotes growth to create jobs and to empower poor people to take advantage of these opportunities. **WORLD TRADE ORGANISATION (WTO) :** WTO was established in January 1, 1995 when the **Uruguay Round GATT negotiations (1986-94)** concluded. It has a membership of 150 countries (more than 90% of world trade). It is the only global international organisation dealing with the rules of trade between nations. Its function is to ensure that trade flows as smoothly, predictably and freely as possible. The heart of the system is the WTO agreements, negotiated and signed by countries and ratified by their parliaments. The goal of WTO is to help producers of goods and services, exporters and importers to conduct their business and thereby improve the welfare of the people. WTO provides legal ground rules for international commerce which is essentially contracts, guaranteeing member countries important trade rights. WTO administers trade agreements and acts as a forum for trade negotiations, settling trade disputes, reviewing national trade policies and assisting developing countries in trade policy issues.

- **YIELD CURVE :** Relation between the interest rate and the time to maturity of the debt for a given borrower in a given currency.

- **YIELD TO MATURITY (YTM) :** The annual return on a bond from the date of acquisition to the date of maturity. It is the discount rate that equates the present value of cashflows from the bond to the current price of the bond. If the bond is bought at par value the yield to maturity is the same as the nominal yield. If bought at premium, the yield to maturity is less than the nominal yield. If bought at discount the yield to maturity is more than the nominal yield.

- **ZERO COUPON BONDS :** The regular government bond has a **"coupon" (interest bearing certificate)** that is **payable twice a year**. Interest is paid two times a year, and therefore, there are regular cash inflows. Such bonds are normally issued at face value and the redemption value of the bond is also the face value. **The subscribers/holders to zero coupon bonds** do not receive any interest during the life of the bonds. Instead investors **buy zero coupon bonds at a deep discount from their face value, which is the amount a bond will be worth when it matures. The maturity dates on zero coupon bonds are normally long term, ten years, fifteen years or more.**