

Commercial Banks



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1. Consider the following statements regarding the role and definition of Commercial Banks:

- 1. Commercial banks are defined by their two most distinctive functions: accepting time deposits and lending long-term funds to industries.**
- 2. The primary source of profit for a commercial bank is the 'spread,' which is the difference between the interest charged on loans and the interest paid on deposits.**
- 3. Institutions like the Post Office, which accept demand deposits but do not provide loans, are classified as commercial banks.**

Which of the statements given above is/are correct?

A 1 and 2 only

B 1 and 3 only

C 2 only

D 1, 2, and 3

Solution

- Statement 1 is Incorrect: The two distinctive functions are accepting deposits (including demand deposits) and lending money. They generally do not provide long-term credit to maintain asset liquidity.

- **Statement 2 is Correct:** The 'spread' is accurately defined as the difference between the lending rate (interest charged to borrowers) and the borrowing rate (interest paid to depositors), which is the bank's main source of profit.
- **Statement 3 is Incorrect:** The document explicitly states that for an institution to be termed a commercial bank, it must perform the dual function of accepting deposits and giving loans; thus, the Post Office is not a commercial bank.
- **Liquidity Constraint:** Commercial banks primarily meet the short-term and medium-term financial needs of industries because their deposits are withdrawn at short notice, necessitating high asset liquidity.
- **Profit-Based Institution:** A commercial bank is fundamentally defined as a profit-based financial institution that acts as an intermediary, taking money from savers and providing it to investors/borrowers.

2. Which of the following acts as a constraint or limitation on the power of commercial banks to create credit?

1. The Cash Reserve Ratio (CRR) fixed by the RBI.
2. Heavy withdrawal of cash by the borrowers (cash leakage).
3. The bank's preference for long-term lending to industries to maintain profitability.
4. The size of the initial primary deposits available to the banking system.

Which of the statements given above is/are correct?

A 1, 3, and 4 only

B 1, 2, and 4 only

C 2 and 4 only

D 1, 2, 3, and 4

Solution

- Constraint 1 is Correct (CRR): The CRR is the most direct and regulatory limit, as it forces the bank to keep a percentage of deposits with the RBI, reducing lendable funds.
- Constraint 2 is Correct (Cash Leakage): Cash withdrawal stops the credit creation cycle, as the money leaves the system, preventing the generation of new derivative deposits.

- **Constraint 3 is Incorrect:** Commercial banks prefer short-term lending to maintain liquidity. Their inability to engage in long-term lending is the result of the liquidity constraint, which in itself limits their overall credit scope.
- **Constraint 4 is Correct (Primary Deposits):** The total credit created is a multiple of the initial Primary Deposits. If the size of these initial deposits is small, the ultimate amount of credit created will also be small.
- **SLR as a Constraint:** Another major regulatory constraint, not listed here but mentioned in the text, is the Statutory Liquidity Ratio (SLR), which also locks up liquid assets, reducing lending capacity.

3. **The two most distinctive and primary functions that exclusively define a Commercial Bank are:**

A Accepting deposits and acting as a Banker to the Government.

B Accepting deposits and issuing Letter of Credit.

C **Accepting deposits and lending money.**

D Lending money and managing foreign exchange.

Solution

- **Core Definition:** Commercial banks are fundamentally defined by their role as financial intermediaries that perform the twin functions of borrowing and lending.
- **Borrowing (Accepting Deposits):** They mobilize savings from the general public by accepting various types of deposits (demand and time deposits).
- **Lending (Granting Loans):** They deploy these mobilized funds by granting loans to individuals, businesses, and industries to earn interest.
- **Profit Motive (Spread):** The difference between the interest rate paid to depositors (borrowing rate) and the interest rate charged to borrowers (lending rate) is called the spread, which is the bank's main source of profit.

- **Exclusivity:** The document specifies that only institutions performing both these dual functions are termed as commercial banks (e.g., Post Offices, which accept deposits but do not generally give loans, are not commercial banks).

4. The 'Spread' appropriated by commercial banks refers to the difference between the:

- A** Amount of demand deposits and time deposits.
- B** Value of assets and the value of liabilities.
- C** Cash Reserve Ratio (CRR) and the Statutory Liquidity Ratio (SLR).
- D** **Borrowing rate offered to depositors and the lending rate charged to borrowers.**

Solution

- **Definition of Spread:** The term Spread is defined in the document as the margin or difference between the bank's cost of funds and its revenue from funds.
- **Borrowing Rate (Cost):** This is the interest rate that the commercial bank pays to its depositors for keeping money with the bank.
- **Lending Rate (Revenue):** This is the interest rate that the commercial bank charges to its customers for providing them with loans and advances.
- **Source of Profit:** The spread represents the primary source of operational profit for a commercial bank, covering administrative costs, provisioning, and shareholder returns.

- **Risk and Term Premium:** The lending rate is always higher than the borrowing rate because it incorporates a premium for the credit risk taken by the bank and the longer tenure of the loan.

5. According to the classification provided in the document, which of the following is NOT a type of Commercial Bank?

A Public Sector Banks

B Private Sector Banks

C Regional Rural Banks

D Co-operative Banks

Solution

- **Top-Level Classification:** The structure shows that Scheduled Banks are broadly categorized into two main groups: Commercial Banks and Co-operative Banks.
- **Commercial Bank Sub-categories:** The document further divides Commercial Banks into four types: Public Sector Banks, Private Sector Banks, Foreign Sector Banks, and Regional Rural Banks (RRBs).
- **Co-operative Banks as a Separate Entity:** Co-operative Banks are listed as a category parallel to Commercial Banks under the Scheduled Banks umbrella, not a sub-type of Commercial Banks.
- **Difference in Ownership:** Co-operative Banks are owned and operated by their members and typically adhere to the principle of

"one member, one vote," unlike Commercial Banks, which are profit-based entities.

- **Regulatory Distinction:** While both are Scheduled Banks, they are governed by different legal frameworks (e.g., the Banking Regulation Act, 1949, and state co-operative society acts).

6. The Statutory Liquidity Ratio (SLR) is a limitation on the credit creation power of commercial banks because it requires them to maintain:

A A certain reserve with the Central Bank only.

B A second line of defence in the form of liquid assets.

C The difference between borrowing and lending rates (the spread).

D Only government securities as collateral for all loans.

Solution

- **Purpose of SLR:** The SLR requirement mandates that commercial banks hold a specific percentage of their deposits in the form of liquid assets.
- **Form of Assets:** These liquid assets can include cash, gold, or unencumbered approved securities (like Government Securities), held by the bank itself, not with the RBI (as with CRR).
- **Credit Curtailment:** By locking a portion of deposits into these mandatory liquid assets, the SLR directly reduces the resources available for the bank to extend loans, thereby curtailing the power of credit creation.
- **Second Line of Defence:** The SLR is considered a second line of defence for the bank's safety, ensuring they have easily convertible

assets to meet high, unexpected withdrawals.

- **RBI Control Tool:** Along with the CRR, the RBI uses the SLR as a quantitative credit control tool to manage the liquidity and lending capacity of commercial banks in the economy.

7. **Commercial banks play a significant role in fulfilling the financial requirements of industries, specifically focusing on:**

A Short-term and medium-term financial requirements.

B Long-term financial requirements to fund capital expenditure.

C Only foreign currency requirements for import/export.

D Issuing equity and preference shares to raise capital.

Solution

- **Term Preference:** Commercial banks specialize in providing loans for short-term and medium-term needs.
- **Liquidity Constraint:** They actively avoid providing long-term credit to ensure that their assets remain liquid, as their liabilities (deposits) are withdrawable at short notice.
- **Nature of Requirement:** Short-term credit typically covers working capital needs of industries (e.g., purchasing raw materials, paying salaries).
- **Long-term Providers:** Long-term capital needs (like buying fixed assets and machinery) are primarily catered to by Development Banks or through capital market instruments.
- **Risk Management:** Short-term loans are generally less risky for the bank and are often secured by tangible and easily marketable assets.

8. **What is the difference between Cash Credit and a Demand Loan as a bank advance?**

A Cash Credit is for fixed deposits, Demand Loan is for current accounts.

B Cash Credit is paid in lump sum, Demand Loan is paid in installments.

C **In Cash Credit, interest is charged only on the withdrawn amount, while in Demand Loan, it is on the sanctioned amount.**

D Cash Credit has no stated maturity, Demand Loan must be repaid within one year.

Solution

- **Cash Credit (Limit):** Cash Credit sanctions a maximum limit up to which a borrower can withdraw funds, typically against the hypothecation of current assets (like inventory).
- **Interest Calculation (Cash Credit):** The key advantage is that the borrower pays interest only on the amount actually utilized (withdrawn) from the sanctioned limit, not on the entire limit.
- **Demand Loan (Lump Sum):** A Demand Loan is paid in a lump sum by crediting the borrower's loan account.
- **Interest Calculation (Demand Loan):** Interest is calculated on the entire sanctioned and disbursed amount of the loan from the date of

disbursement, regardless of whether the borrower uses all the funds immediately.

- **Repayment/Recall:** Both are typically used for short-term working capital needs, and a Demand Loan can be recalled by the bank without a fixed maturity.

9. **What distinguishes 'Current Account Deposits' from 'Fixed Deposits' offered by a Commercial Bank?**

A Current accounts are not payable on demand, while Fixed deposits are.

B Fixed deposits carry a lower rate of interest than Current accounts.

C Current accounts offer cheque facilities, while Fixed deposits do not.

D

Current accounts are not withdrawn by the depositors any number of times.

Solution

- **Cheque Facility:** Current accounts are the primary deposit type that enjoys the facility of withdrawal through cheques for making payments.
- **Fixed Deposit Feature:** Fixed Deposits (or Time Deposits) are held for a specific period and are not payable on demand and consequently do not enjoy cheque facilities.
- **Interest Rate:** Current accounts typically pay no interest, whereas Fixed Deposits carry a higher rate of interest because the money is locked in for a fixed term.
- **Withdrawal Frequency:** Current accounts are primarily meant for businesses and allow unlimited withdrawals (though sometimes fees

apply after a high limit), while Fixed Deposits are meant for savings and cannot be withdrawn before maturity without a penalty.

- **Money Supply:** The text notes that Fixed Deposits are not treated as a part of money supply (M1), while Current Deposits (along with Savings and Cash) are highly liquid and form part of the narrow definition of money supply.

10. A customer who has a Current Account is allowed to overdraw his account up to an agreed limit. The security for this arrangement is generally financial assets like shares and debentures. This facility is known as:

A Cash Credit

B Demand Loan

C Short-term Loan

D Overdraft Facility

Solution

- Target Customer: The Overdraft facility is specifically available to customers holding a Current Account with the bank.
- Mechanism: It allows the customer to withdraw (or overdraw) an amount greater than the credit balance in their account, up to a pre-agreed and sanctioned limit.
- Interest Charge: A major benefit is that interest is charged only on the actual amount withdrawn (the amount overdrawn) and only for the period it is used, not the full sanctioned limit.
- Security: The facility is typically secured by easily liquidated assets, such as shares, debentures, or life insurance policies, as mentioned in the text.

- **Liquidity Tool:** It serves as a very flexible, short-term borrowing mechanism for businesses that need temporary working capital.

11. **Examine the following reasons for commercial banks' preference for short-term lending:**

- 1. Their preference helps them maintain the high liquidity of their assets, as their deposit liabilities are mostly demand-based.**
- 2. Short-term loans are less risky and are often backed by tangible and easily marketable securities.**
- 3. They must reserve their long-term funds to meet the Statutory Liquidity Ratio (SLR) requirement.**

Which of the statements given above is/are correct?

A 1 and 3 only

B 1 and 2 only

C 2 and 3 only

D 1, 2, and 3

Solution

- **Statement 1 is Correct:** Bank funds belong to the public and are withdrawable at short notice. Therefore, limiting credit to a short period ensures the speedy return of funds, thus maintaining asset liquidity.
- **Statement 2 is Correct:** By lending for short terms against tangible and easily marketable securities, the bank minimizes the risk of loss

and ensures quick recovery in case of default.

- **Statement 3 is Incorrect:** The SLR requirement is a constraint forcing banks to hold a fraction of their liabilities as liquid assets (like government securities), but it does not reserve their long-term funds (which they generally do not hold) for this purpose.
- **Focus on Working Capital:** Commercial banks primarily finance the short-term and medium-term working capital requirements of industries, which are inherently short-cycle needs.
- **Role of Development Banks:** Long-term capital expenditure is typically financed by specialized Development Banks or raised through the capital markets, as commercial banks are structurally unsuitable for this role.

12. Which of the following statements about Scheduled Banks in India is/are correct?

1. They are included in the Second Schedule of the Reserve Bank of India Act, 1934.
2. They automatically acquire membership of the clearing house.
3. They are eligible to get debt/loans from the RBI at the Bank Rate.
4. The State Bank of India (SBI) is the only Public Sector Bank categorized as a Scheduled Bank.

Which of the statements given above is/are correct?

A 1, 2, and 4 only

B 1, 2, and 3 only

C 2, 3, and 4 only

D 1, 3, and 4 only

Solution

- Statement 1 is Correct: The legal definition of a Scheduled Bank is based on its inclusion in the Second Schedule of the RBI Act, 1934.
- Statement 2 is Correct: A key privilege associated with being a Scheduled Bank is the automatic acquisition of membership in the clearing house (facilitating inter-bank payment settlement).

- **Statement 3 is Correct:** Another major privilege is the eligibility to avail debts/loans from the RBI at the Bank Rate, providing access to central bank liquidity.
- **Statement 4 is Incorrect:** All major banks, including all Public Sector Banks (like PNB, BOB, Canara Bank, etc.), Private Sector Banks, Foreign Banks, and RRBs, are generally Scheduled Banks if they meet the criteria. SBI is not the only one.
- **Obligations:** In return for these privileges, Scheduled Banks must adhere to strict RBI regulations, including maintaining the required Cash Reserve Ratio (CRR).

13. With reference to the different types of deposits accepted by commercial banks, consider the following statements:

1. Current Account deposits are neither payable on demand nor do they offer cheque facilities, but they earn the highest rate of interest.
2. Fixed Deposits (Time Deposits) are not treated as a part of money supply (M1) due to their lack of immediate liquidity and redeemability.
3. Demand Deposits are critical for credit creation as they serve as the principal medium of exchange in the banking system.

Which of the statements given above is/are correct?

A 1 only

B 1 and 2 only

C 2 and 3 only

D 3 only

Solution

- Statement 1 is Incorrect: Current Account deposits are payable on demand and offer cheque facilities, but they typically pay no interest, not the highest rate. This description better fits Fixed Deposits in terms of interest and lack of demand-payability.

- **Statement 2 is Correct: Fixed Deposits are Time Deposits (held for a fixed term).** Since they are not immediately withdrawable by cheque, they are classified as non-liquid and are specifically stated as not treated as a part of money supply (M1).
- **Statement 3 is Correct: Credit creation works because when loans are granted, they become new Demand Deposits, which are used as a medium of exchange (via cheques or transfers) in the economy, circulating the credit created.**
- **Maturity Distinction: The key distinction among deposit types is maturity/payability: Demand Deposits (Current/Savings) are payable on demand, while Time Deposits (Fixed/Recurring) are payable after a specific period.**
- **Cheque Facility and Liquidity: The ability to use cheques (a feature of Demand Deposits) is directly linked to the money supply concept and the functioning of credit creation, highlighting their high liquidity.**

14. Which of the following is considered the primary function of a Commercial Bank?

A Providing locker facilities

B Underwriting shares and debentures

C Accepting deposits and granting loans/advances

D Dealing in foreign exchange

Solution

- **Defining Activity:** The primary functions are the two fundamental activities that define a commercial bank and are crucial for its profitability.
- **Accepting Deposits:** This is the process of mobilizing savings from the public (Demand Deposits, Time Deposits), forming the bank's main source of funds (Liabilities).
- **Granting Advances:** This involves lending money to individuals and businesses (Loans, Cash Credit, Overdraft), which is the bank's main source of income (Assets).
- **Agency/General Services:** Options A, B, and D (Locker, Underwriting, Forex) are categorized as secondary or agency functions, supporting the core business but not defining it.

- **Role in Economy:** This dual function is essential for a commercial bank's role as a financial intermediary, facilitating investment and consumption in the economy.

15. A bank deposit that is withdrawable by the customer without prior notice and includes current account and savings account deposits is termed as:

A Demand Deposit

B Time Deposit

C Statutory Deposit

D Term Deposit

Solution

- **Definition:** Demand Deposits are those funds that can be withdrawn or transferred by the depositor "on demand" or immediately, usually by cheque, ATM, or digital transfer.
- **Instruments:** They primarily include balances in Current Accounts and the demand portion of Savings Accounts.
- **Liquidity:** These deposits possess the highest level of liquidity, as the bank must be ready to pay them out at any time.
- **NDTL Component:** Demand Deposits are a major component used when calculating the Net Demand and Time Liabilities (NDTL) base for CRR and SLR.
- **Time Deposit Contrast:** They contrast with Time Deposits (Fixed Deposits/Term Deposits), which can only be withdrawn after a

specified period or with a penalty.

16. **The difference between the rate of interest earned by a commercial bank on its loans and the rate of interest paid on its deposits is known as:**

A Cash Reserve Ratio (CRR)

B Spread

C Treasury Bill Rate

D Capital Adequacy Ratio (CAR)

Solution

- **Spread Definition:** The Spread is the gross profit margin of a bank, representing the difference between the interest income (earned on loans) and the interest expenditure (paid on deposits/borrowings).
- **Profitability Indicator:** It is a key indicator of a bank's profitability and efficiency in managing its assets and liabilities.
- **Risk Premium:** A portion of the spread covers the risk premium associated with lending, administrative costs, and the bank's profit margin.
- **NIM (Net Interest Margin):** The ratio of Net Interest Income to the bank's earning assets is the Net Interest Margin (NIM), a refined measure of this profitability.

- **Financial Intermediation:** The ability to generate a positive and sufficient spread is fundamental to the bank's role as a successful financial intermediary.

17. The 'Accepting Bills of Exchange' and 'Letter of Credit (LC)' functions of a commercial bank fall under the category of:

A Primary Functions

B Agency Functions / Contingent Liability

C General Utility Functions

D Credit Creation Functions

Solution

- **Agency Function:** Agency functions involve the bank acting as an agent or representative for its customers (e.g., collecting/paying bills, remittances).
- **Contingent Liability:** When a bank accepts a Bill of Exchange or issues a Letter of Credit (LC), it creates a contingent liability—a potential future obligation that depends on a future event (i.e., the default of the customer).
- **Trade Facilitation:** LCs are crucial for international trade, guaranteeing payment on behalf of the importer to the exporter, thus reducing risk.
- **Fee Income:** These services generate significant non-interest income (fee income) for the bank.

- **Distinction:** They are distinct from Primary Functions (deposit/loan) and General Utility Functions (lockers, travelers' cheques).

18. Which of the following tools is used by commercial banks to lend money to a customer by permitting them to withdraw funds more than the balance in their current account?

A Cash Credit

B Term Loan

C Overdraft Facility

D Discounting Bills of Exchange

Solution

- **Overdraft Definition:** An Overdraft is a short-term lending facility extended primarily to current account holders (usually businesses) that allows them to overdraw their account up to a pre-approved limit.
- **Interest Charge:** Interest is charged only on the amount that is actually overdrawn, not on the sanctioned limit.
- **Security:** It is usually secured by assets, but the facility's convenience lies in its immediate availability and flexible usage.
- **Cash Credit Contrast:** Cash Credit (A) is similar but typically granted against the hypothecation of stock/receivables and involves creating a separate loan account.

- **Liquidity Management:** The Overdraft facility is a crucial instrument for businesses to manage short-term working capital needs and cash flow mismatches.

19. **The largest category, by number of banks, among the Scheduled Commercial Banks (SCBs) in India is typically:**

A Public Sector Banks (PSBs)

B Private Sector Banks

C Foreign Banks

D Regional Rural Banks (RRBs)

Solution

- **RRB Status:** RRBs are categorized as Scheduled Commercial Banks but were established under the RRB Act, 1976.
- **Large Number:** They operate at the district level and were established in large numbers across India, making their count significantly higher than the relatively few PSBs, Private Banks, or Foreign Banks.
- **Purpose:** RRBs were created to provide credit and other facilities to small and marginal farmers, agricultural laborers, and artisans in rural areas.
- **Ownership Structure:** They are jointly owned by the Central Government (50%), State Government (15%), and a Sponsor Bank (35%).

- **Focus:** Their classification as SCBs ensures they adhere to RBI regulations like CRR/SLR while maintaining a strong rural focus.

20. **Small Finance Banks (SFBs) are primarily licensed to carry out which type of banking activity, in contrast to Payments Banks?**

A Merchant Banking

B Acceptance of deposits and provision of small loans

C Only remittance services

D Foreign exchange trading only

Solution

- **SFB Mandate:** SFBs were created to further financial inclusion by providing savings vehicles and, crucially, supplying credit to unserved and underserved sections of the economy.
- **Lending Role:** Unlike Payments Banks, SFBs can and must engage in lending activities, specifically focusing on micro-loans, micro-enterprises, and small farmers.
- **Capital Base:** They have a larger initial capital requirement than Payments Banks to support their lending operations.
- **Priority Sector:** A large portion of their lending must be directed towards the Priority Sector as mandated by the RBI.
- **Full-Service Limitations:** While they are Scheduled Commercial Banks, they have restrictions (e.g., they cannot establish subsidiaries) that full-service commercial banks do not.

21. If the Cash Reserve Ratio (CRR) is 5% and the Statutory Liquidity Ratio (SLR) is 15%, the maximum percentage of an initial deposit a commercial bank can use for lending is:

A 20%

B 5%

C 80%

D 100%

Solution

- Total Reserve Requirement: The total amount a bank must keep as statutory reserves is $CRR + SLR = 5\% + 15\% = 20\%$.
- Loanable Funds: The portion of the deposit that is loanable is the residual percentage after meeting the reserve requirements.
- Calculation: $\text{Loanable funds} = 100\% - \text{Total Reserve Requirement} = 100\% - 20\% = 80\%$.
- Impact on Credit: The higher the reserve ratio, the lower the loanable funds, and consequently, the lower the potential for credit creation.
- Safety vs. Growth: The reserve ratios balance the need for safety/liquidity (reserves) against the need for economic growth (lending).

22. **What is the final result of the commercial banking system's credit creation process on the national economy?**

A Decrease in the total money supply

B Neutral effect on money supply

C Increase in the total money supply

D Increase in the foreign currency reserves

Solution

- **Money Supply Definition:** Money supply includes currency with the public and demand deposits held with commercial banks.
- **Creation of Deposits:** Credit creation increases the total volume of demand deposits in the banking system, which is a key component of the M1 measure of money supply.
- **Economic Impact:** This increase in the money supply facilitates more investment and consumption, stimulating economic activity.
- **RBI vs. Commercial Banks:** The RBI creates the high-powered money (base money), while commercial banks use it to create credit money (deposit money).
- **Inflation Risk:** Uncontrolled credit creation, however, can lead to excess liquidity and inflationary pressure in the economy.

23. **If a commercial bank's primary purpose is profit maximization, how does the CRR indirectly affect this goal?**

A By increasing the interest rate on loans

B By reducing the volume of loanable funds, thus limiting profit

C By increasing the total deposits of the bank

D By guaranteeing the bank's profitability

Solution

- **Lending and Profit:** A commercial bank's main source of profit is the interest earned on its loans and advances.
- **CRR Impact:** CRR is the portion of deposits that the bank must keep with the RBI on which it earns no interest (non-interest bearing).
- **Opportunity Cost:** The CRR creates an opportunity cost for the bank by reducing the amount of funds available for profitable lending.
- **Inverse Relationship:** Thus, a higher CRR directly limits the bank's capacity to lend and, consequently, reduces its potential for profit maximization.
- **Risk Mitigation:** The RBI imposes this requirement to mitigate risk and control money supply, overriding the bank's profit motive.

24. **The system that facilitates the real-time transfer of funds from one bank to another, especially for large-value transactions in India, is:**

A NEFT (National Electronic Funds Transfer)

B RTGS (Real-Time Gross Settlement)

C IMPS (Immediate Payment Service)

D CTS (Cheque Truncation System)

Solution

- **RTGS Definition:** RTGS is a payment system where the transfer of money takes place continuously on a transaction-by-transaction basis (gross settlement) and in real-time.
- **Value Threshold:** It is primarily used for high-value transactions (currently with a minimum amount of ₹2 lakh).
- **Finality:** Settlement through RTGS is final and irreversible, making it suitable for secure and large commercial payments.
- **NEFT Contrast:** NEFT (A) settles transactions in batches at specific time intervals, which is why it is not "real-time."
- **Risk Mitigation:** By settling individually and immediately, RTGS significantly reduces settlement risk in the financial system.

25. In the context of banking and the money market, 'Treasury Bills' (T-Bills) are primarily used by commercial banks for which purpose?

- A** Long-term infrastructure financing
- B** Meeting Priority Sector Lending targets
- C** Meeting the Statutory Liquidity Ratio (SLR) requirement
- D** Providing credit to the non-banking financial sector

Solution

- **T-Bills Nature:** T-Bills are short-term debt instruments issued by the Government of India, making them highly secure and liquid.
- **SLR Eligibility:** Since T-Bills are government securities, they are explicitly designated as eligible assets for meeting the Statutory Liquidity Ratio (SLR) requirement.
- **Risk-Free Asset:** Banks prefer T-Bills as they are virtually risk-free in terms of default and provide a minimum return.
- **Liquidity:** Their short maturity and high liquidity make them ideal for managing a bank's reserve position.
- **Money Market Instrument:** T-Bills are a major component of the Indian money market.

26. **The Capital to Risk-weighted Assets Ratio (CRAR) is a key measure of a commercial bank's:**

A Operating Efficiency

B Profitability

C Solvency and Stability

D Market Share

Solution

- **CRAR Definition:** CRAR (or CAR) is the ratio of a bank's capital to its risk-weighted assets (loans, investments, etc., weighted by their associated risk).
- **Solvency Test:** It is the primary metric used globally (under the Basel Accords) to assess a bank's ability to absorb unexpected losses, confirming its solvency.
- **Risk Management:** A higher CRAR indicates better stability and a greater capacity to withstand shocks without becoming insolvent.
- **Regulatory Minimum:** The RBI mandates a minimum CRAR for all commercial banks, reflecting the required safety standards.
- **Basel III:** Indian commercial banks adhere to the higher capital requirements specified under the Basel III framework.

27. **The majority stake (51% or more) in Public Sector Banks (PSBs) in India is held by:**

A Government of India

B Reserve Bank of India (RBI)

C National Bank for Agriculture and Rural Development

D Private Shareholders

Solution

- **Ownership Definition:** Public Sector Banks (PSBs) are those where the majority ownership (more than 50% equity) is held by the Government of India.
- **RBI's Role:** The RBI is the regulator, not the owner, of PSBs.
- **Strategic Control:** Government ownership ensures that the banks can be directed to fulfill socio-economic objectives, such as implementing priority sector lending targets and government schemes.
- **Governance:** The management and appointment of key personnel in PSBs often involve the direct intervention of the Government (through the Ministry of Finance).
- **Contrast:** Private Sector Banks have majority ownership held by private individuals/institutions (D), while Foreign Banks are

primarily owned abroad.

28. In the context of the money multiplier, the term 'Reserve Ratio' includes which two mandatory ratios for a Scheduled Commercial Bank?

A Cash Reserve Ratio (CRR) and Statutory Liquidity Ratio (SLR)

B Repo Rate and Reverse Repo Rate

C Capital Adequacy Ratio and Non-Performing Assets

D Bank Rate and Base Rate

Solution

- **Money Multiplier Formula:** The potential money multiplier is calculated as $1/\text{Reserve Ratio}$.
- **Reserve Ratio Components:** For a commercial bank, the total reserve ratio that restricts lending is the sum of the CRR (kept with the RBI) and the SLR (kept with the bank itself).
- **Mandatory Restriction:** Both are statutory requirements that must be met, reducing the amount of money available for fresh lending.
- **Lending Ceiling:** The sum (CRR + SLR) represents the legal ceiling on how much a bank must retain against its deposits.
- **Policy Tools:** Both CRR and SLR are policy tools used by the RBI to manage liquidity and the overall money supply.

29. **Which international agreement/framework dictates the Capital Adequacy Ratio (CAR) norms followed by Indian Commercial Banks?**

A Kyoto Protocol

B Bretton Woods Agreement

C **Basel Accords (currently Basel III)**

D WTO Agreement

Solution

- **Basel Committee:** The Basel Accords are a set of international banking regulations issued by the Basel Committee on Banking Supervision (BCBS) in Switzerland.
- **CAR/CRAR:** These accords define the Capital Adequacy Ratio (CAR) or Capital to Risk-weighted Assets Ratio (CRAR) that banks must maintain to ensure they can absorb a reasonable amount of unexpected losses.
- **Global Standard:** Basel III, the current framework, sets the global standard for capital requirements, leverage, and liquidity for internationally active banks.
- **RBI Implementation:** The RBI has largely implemented the Basel III norms for all commercial banks in India.

- **Risk Management:** Maintaining CAR is crucial for managing the three major risks in banking: credit risk, market risk, and operational risk.

30. According to the classification of the banking system in India as per the reference document, which of the following statements is/are correct?

1. Scheduled Banks include both Commercial Banks and Co-operative Banks.
2. Regional Rural Banks (RRBs) are a type of Co-operative Bank focused on agriculture and rural credit.
3. Public Sector Banks are defined by the government holding the major stake or share capital.

Which of the statements given above is/are correct?

A 1 only

B 2 and 3 only

C 1 and 3 only

D 1, 2, and 3

Solution

- Statement 1 is Correct: The document's classification chart shows that Scheduled Banks are broadly categorized into Commercial Banks and Co-operative Banks.
- Statement 2 is Incorrect: RRBs are a type of Commercial Bank (jointly owned by GoI, State Govt., and Sponsor Bank), not a Co-

operative Bank. Co-operative Banks are a separate category of Scheduled Banks.

- Statement 3 is Correct: Public Sector Banks are explicitly defined as commercial banks in which the major stake or share capital is held by the government (nationalized banks).
- Foreign Banks: The classification also includes Foreign Banks, which are headquartered abroad but operate branches in India, as a type of commercial bank.
- Definition of Scheduled Bank: A Scheduled Bank must be included in the Second Schedule of the RBI Act, 1934, and is eligible to avail loans from the RBI at the Bank Rate.



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