COURSE CODE: 321 - FINANCIAL SERVICES

MBA 3RD SEM

Unit – I

Overview of Financial Services: Nature, Scope and Importance Financial System and Markets: Types, Constituents and Functioning, SEBI Role and Functions, Overview of Foreign Markets, Financial Sector Reforms in India.

Unit – II

Banking and Insurance Services: RBI – Role and Functions. Primary and Secondary Markets and their Intermediaries: Introduction of Primary & Secondary Markets (BSE, NSE & OTCEI), Money Market, Merchant Banking Services - New Issue Management, Prospectus of Public Offering, Book Building, IPO and FPO. Green shoe Option, Underwriter, Registrar and Share Transfer Agent. Stock broking, Depositories, Custodial Services, Short Selling. Securities Lending and Borrowing Services.

Unit – III

Lease financing: Different Types of Leases – Evaluating a Financial Lease. Hire Purchase, Consumer Credit, Credit Card, Debit Card – Factoring, Bill Discounting, Forfeiting, Reverse Mortgage, BNPL.

Unit – IV

Mutual Fund Organisations: Meaning, Status, Types. Venture Capital Financing. Credit Rating Services. Portfolio Management Services, Wealth Management.

Unit – V

Consumer Finance, Housing Finance, Securitization in India: Concept, Nature, Scope and their Implications, Management of Non-Banking Financial Companies and Microfinance

UNIT – I: OVERVIEW OF FINANCIAL SERVICES & THE FINANCIAL SYSTEM

1. NATURE, SCOPE, AND IMPORTANCE OF FINANCIAL SERVICES

1.1 Meaning and Definition of Financial Services

Financial services encompass the economic activities, facilities, and advisory support provided by financial institutions, regulatory bodies, and market intermediaries to manage monetary assets and transactions. They constitute the operational backbone of modern economies by enabling the mobilization, deployment, allocation, and transformation of financial resources.

In legal and functional terms, financial services represent intangible financial products offered by authorized entities—such as commercial banks, non-banking financial companies (NBFCs), insurance firms, mutual fund organizations, stockbroking houses, and investment advisory firms. These services facilitate seamless capital allocation, trade clearance, risk mitigation, asset accumulation, and wealth distribution for individuals, enterprises, and public administration entities.

1.2 Characteristics and Nature of Financial Services

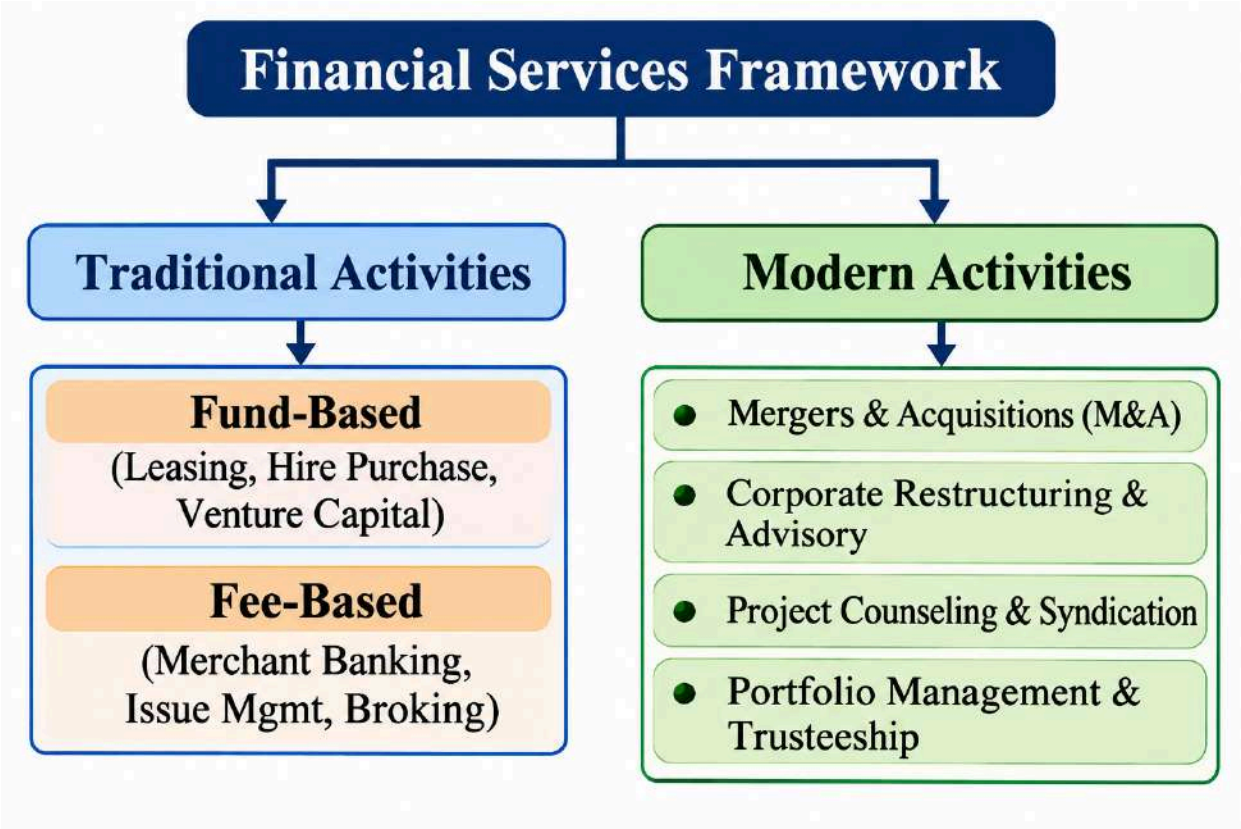
Financial services display distinct features that separate them from tangible consumer or capital goods:

1. **Customer-Centric Architecture:** Financial products are inherently tailored to meet the dynamic risk appetites, liquidity goals, tax liabilities, and return expectations of corporate, institutional, and retail clients.
2. **Intangibility:** Financial services are non-physical. Consequently, institutional reputational capital, corporate governance transparency, brand equity, and regulatory compliance determine client trust and market participation.
3. **Inseparability (Simultaneous Production and Consumption):** Unlike manufactured inventory, financial services are produced and consumed concurrently. The execution of a fund transfer, execution of a stock broker's order, or issuance of an insurance contract occurs live at the point of contact between the intermediary and the customer.

4. **Fund Management Efficiency:** Financial services focus on optimizing the utilization of capital by aggregating small domestic savings and reallocating them into high-yielding corporate, infrastructural, or public investments.
5. **Economic Intermediation:** Financial intermediaries operate as structural bridges connecting surplus economic units (savers and investors) with deficit economic units (corporate borrowers, entrepreneurs, and governments).
6. **Dynamic Market-Driven Adaptation:** Financial services continually evolve in response to technological disruptions (e.g., blockchain, artificial intelligence), shifting macroeconomic parameters, regulatory shifts, and international capital flows.
7. **Risk Diversification and Transfer:** A core operational feature of financial services is risk isolation, pricing, and pooling. By utilizing financial derivatives, insurance contracts, and diversified portfolio structures, institutions shift concentration risks away from risk-averse participants to specialized risk-bearing entities.

1.3 Scope of Financial Services

The scope of financial services covers operational, transactional, and advisory categories, structured into **Traditional Activities** and **Modern Activities**.



A. Traditional Activities

Traditional activities represent core capital and money market operational functions, divided into:

- **Fund-Based Activities:** Transactions involving direct deployment of financial capital, asset acquisitions, or credit advances. Key functions include:
    - Primary and secondary market equity and debt investments.
    - Money market instrument dealings (Treasury Bills, Commercial Paper, Certificates of Deposit).
    - Foreign exchange transactions and international trade financing.
    - Hire purchase financing, equipment leasing, and asset-backed credit.
    - Venture capital funding and housing project finance.
- **Non-Fund-Based (Fee-Based) Activities:** Specialized advisory and administrative services rendered in return for commissions, management fees, or retainers without deploying direct institutional capital. Key functions include:
    - Public issue management and merchant banking.
    - Stockbroking, trade execution, and clearing services.
    - Portfolio Management Services (PMS).
    - Credit rating assignment and financial appraisal.
    - Issuance of Letters of Credit (LCs), Bank Guarantees (BGs), and underwriting commitments.

B. Modern Activities

Driven by global market integration and financial engineering, modern activities address strategic, complex corporate requirements, including:

- Formulating and executing corporate mergers, acquisitions, joint ventures, and strategic takeovers.
- Designing optimal capital structures and executing debt-equity corporate restructurings.
- Developing rehabilitation, turnaround, and debt reconstruction plans for distressed or sick industrial enterprises.
- Managing sovereign and corporate treasury assets, liquidity pools, and risk management portfolios.
- Offering comprehensive project counseling, including feasibility assessment, risk evaluation, and international loan syndication.
- Serving as debenture trustees, asset custodians, and legal fiduciaries for collective investment schemes.

1.4 Importance of Financial Services

Financial services drive economic expansion, industrial capacity building, and societal welfare through the following mechanisms:

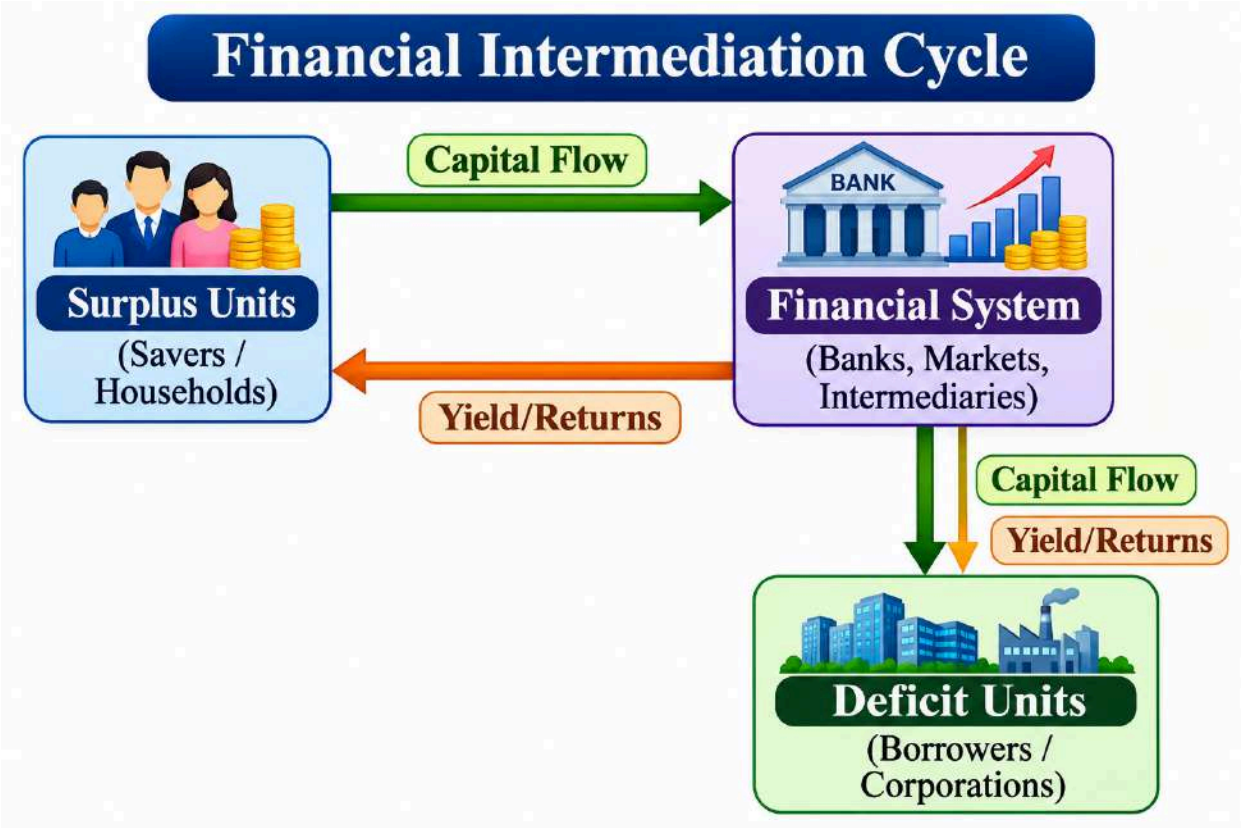
1. **Capital Formation Enhancement:** By aggregating fragmented domestic household savings into structured investment vehicles, financial services construct long-term national capital assets.
2. **Investment & Industrial Growth:** Provision of specialized capital (leasing, venture capital, private equity, debt syndication) enables business enterprises to adopt state-of-the-art technology, expand production facilities, and capture international markets.
3. **Efficient Financial Intermediation:** Minimizes financial transaction costs and information asymmetry by connecting capital providers directly with productive capital users.
4. **Comprehensive Risk Mitigation:** Enables corporate enterprises and individual citizens to insulate themselves against currency volatility, interest rate shocks, property damage, health emergencies, and market downswings.
5. **Employment Generation:** Directly creates high-skill employment opportunities across banking, insurance, investment funds, and fintech domains, while indirectly stimulating employment across commercial and industrial supply chains.
6. **Balanced Regional Development:** Channels target priority sector lending, microfinance, and rural credit to backward regions, bridging economic disparities and promoting financial inclusion.
7. **Government Public Finance Support:** Assists monetary authorities and national treasuries in floating government bonds, Treasury Bills, and municipal notes to fund public infrastructure and social sector projects.
8. **Elevation of Living Standards:** Consumer finance solutions (mortgages, auto credit, personal loans, card products, BNPL) empower households to acquire durable assets, fund higher education, and upgrade living conditions.

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2. FINANCIAL SYSTEM AND MARKETS: TYPES, CONSTITUENTS, AND FUNCTIONING

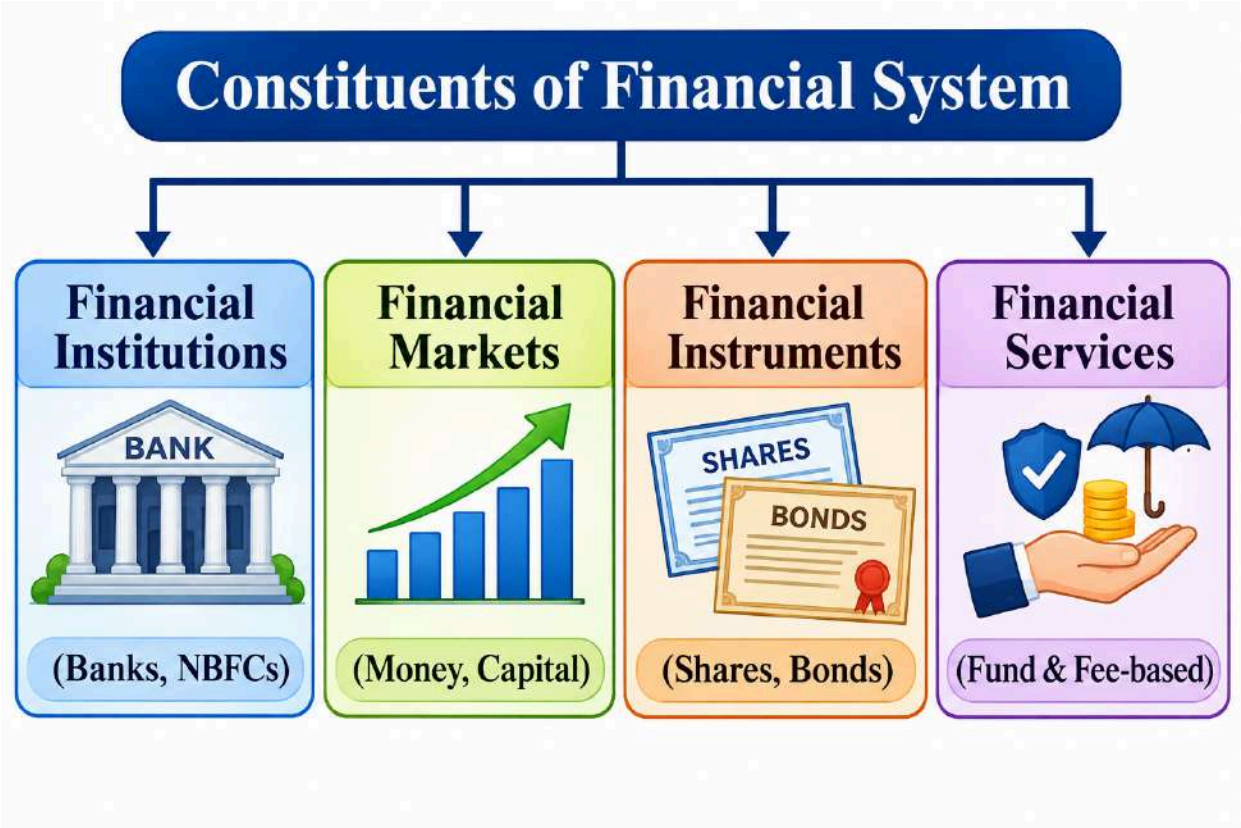
2.1 Meaning and Concept of the Financial System

A financial system constitutes an institutional network of monetary frameworks, regulatory bodies, capital markets, financial intermediaries, and financial instruments that facilitate financial flows within an economy. It transforms idle liquid assets into high-productivity capital investments.



In India, the institutional framework of the financial system comprises the Reserve Bank of India (RBI), Securities and Exchange Board of India (SEBI), Insurance Regulatory and Development Authority of India (IRDAI), Pension Fund Regulatory and Development Authority (PFRDA), commercial and cooperative banks, NBFCs, stock exchanges, depositories, and asset management companies.

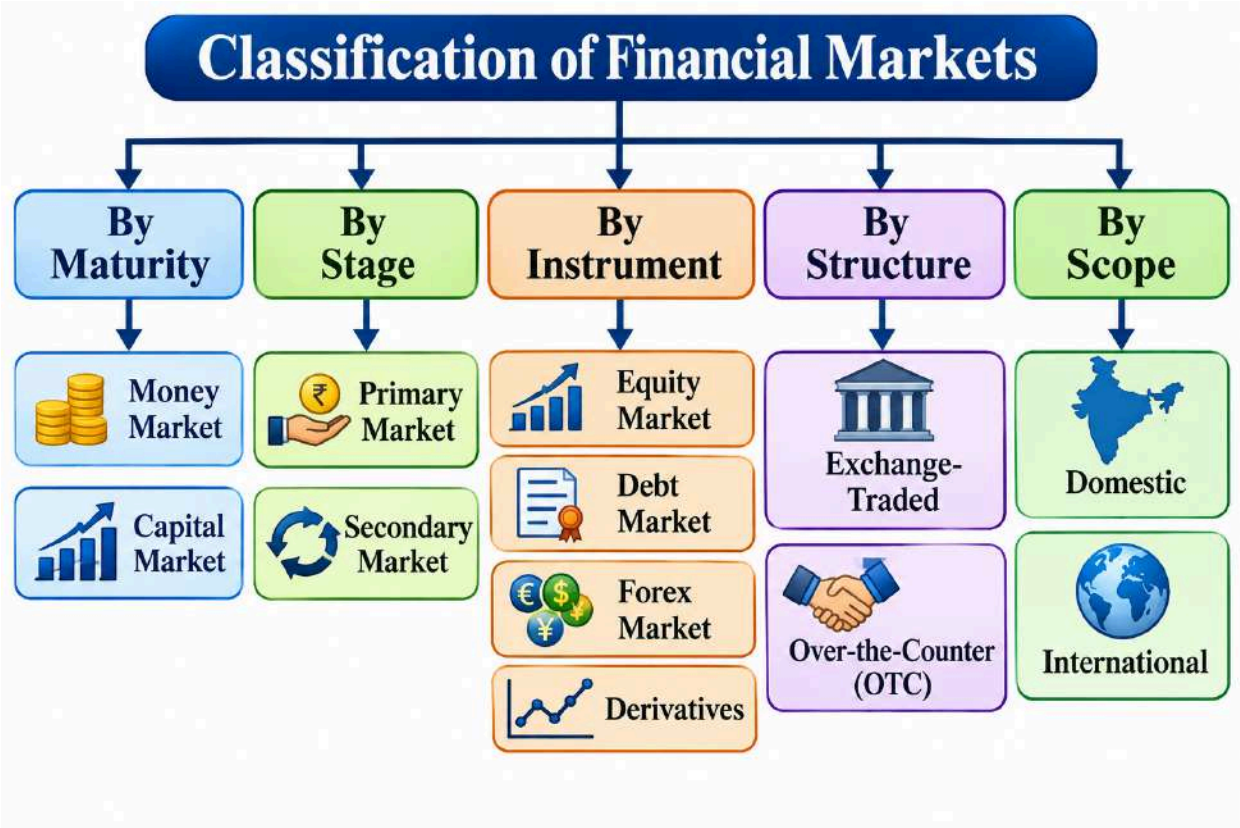
2.2 Interdependent Constituents of the Financial System



Financial Institutions: Regulated entities operating as financial intermediaries that collect funds, evaluate creditworthiness, absorb operational risks, and structure financial products (e.g., Commercial Banks, Development Financial Institutions, NBFCs, Insurance Firms).

1. **Financial Markets:** Institutional platforms and electronic venues where buyers and sellers exchange financial claims, instruments, and debt-equity contracts, facilitating transparent pricing and asset liquidity (e.g., Money Market, Capital Market, Foreign Exchange Market).
2. **Financial Instruments:** Legal contracts representing financial claims, future cash flows, debt obligations, or fractional equity ownership (e.g., Equity Shares, Corporate Bonds, Government Securities, Treasury Bills, Derivatives).
3. **Financial Services:** Specialized professional services that support asset transfers, payment clearing, liquidity management, risk management, and capital raising (e.g., Merchant Banking, Underwriting, Custodial Services).

2.3 Typology of Financial Markets



A. Classification Based on Fund Maturity

- **Money Market:** A wholesale operational market for ultra-short-term debt instruments having maturities ranging from overnight up to one year (e.g., Call Money, Treasury Bills, Commercial Paper, Certificates of Deposit). It is regulated primarily by central banks to manage banking sector liquidity.
- **Capital Market:** The financial platform for medium- and long-term funds (maturities exceeding one year or perpetual equity). It supports long-term corporate capital expenditure, infrastructure projects, and asset creation (e.g., Equity Shares, Debentures, Infrastructure Bonds).

B. Classification Based on Transaction Stage

- **Primary Market (New Issues Market):** The market segment where corporate entities, statutory bodies, and governments issue fresh securities directly to investors to raise new capital (e.g., IPOs, FPOs, Rights Issues, Private Placements).
- **Secondary Market:** The market platform where previously issued securities are traded among retail and institutional investors (e.g., Stock Exchanges like BSE and

NSE). It provides asset liquidity and real-time price discovery without changing the capital base of the issuing entity.

C. Classification Based on Instrument Type

- **Equity Market:** Venue for trading fractional equity ownership shares in public corporations.
- **Debt Market:** Marketplace dedicated to fixed-income instruments, including sovereign debt (G-Secs), municipal bonds, and corporate debentures.
- **Foreign Exchange (Forex) Market:** Global decentralized market for trading sovereign currencies, establishing exchange rates, and facilitating international payments.
- **Derivatives Market:** Financial market trading contracts whose value derives from underlying reference assets, indices, commodities, or interest rates (e.g., Futures, Options, Swaps).

D. Classification Based on Trading Mechanism

- **Exchange-Traded Market:** Highly standardized, centralized trading venues operating under strict regulatory oversight, automated order-matching engines, and central counterparty settlement guarantees (e.g., NSE, BSE).
- **Over-the-Counter (OTC) Market:** Decentralized, customized bilateral dealer networks where counterparties negotiate contractual terms directly outside centralized exchange rules.

E. Classification Based on Geographical Jurisdiction

- **Domestic Financial Market:** Financial transactions operating entirely within the legal borders and sovereign regulatory jurisdiction of a single country, denominated in domestic currency.
- **International Financial Market:** Financial markets facilitating cross-border capital allocations, multi-currency financing, and international security issuances (e.g., Eurobond market, GDR/ADR listings).

2.4 Operational Dynamics of the Financial System

The financial system executes its intermediation cycle across six integrated stages:

1. **Savings Mobilization:** Aggregating small domestic savings via deposit accounts, mutual funds, pension funds, and insurance plans.
2. **Credit Evaluation & Risk Assessment:** Deploying institutional mechanisms to analyze borrower creditworthiness, collateral quality, and repayment capacity to mitigate non-performing asset creation.
3. **Fund Raising & Security Issuance:** Structuring and floating equity shares, corporate debentures, or money market instruments matching corporate capital budgets.

4. **Strategic Fund Allocation:** Allocating investable capital toward highly productive economic sectors, technology initiatives, and infrastructure projects to optimize risk-adjusted returns.
5. **Secondary Trading & Asset Liquidity:** Providing operational market liquidity via secondary stock exchanges, allowing investors to enter or exit positions seamlessly.
6. **Clearing, Settlement, & Contractual Compliance:** Executing trade matching, security dematerialization, payment clearing, interest distribution, and principal redemption upon contract maturity.

2.5 Money Market vs. Capital Market: Analytical Comparison

Comparative Feature	Money Market	Capital Market
Primary Definition	Market for short-term financial assets and liquid debt instruments.	Market for long-term debt securities and perpetual equity capital.
Maturity Period	Ranging from overnight up to 1 year maximum.	Exceeding 1 year (medium-term, long-term, or perpetual).
Primary Function	Managing working capital requirements and short-term liquidity mismatches.	Funding capital expansion, project setup, and long-term asset creation.
Core Instruments	Treasury Bills, Commercial Paper, Certificates of Deposit, Call Money.	Equity Shares, Preference Shares, Debentures, Corporate Bonds, G-Secs.
Primary Participants	Central Bank (RBI), Commercial Banks, Corporate Treasuries, NBFCs, Mutual Funds.	Retail Investors, Foreign Portfolio Investors (FPIs), Mutual Funds, Insurance Companies.
Risk-Return Profile	Substantially lower credit/market risk, high liquidity, lower yield rates.	Higher market risk, capital volatility, higher potential returns and dividends.
Regulatory Body	Reserve Bank of India (RBI).	Securities and Exchange Board of India (SEBI).

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3. SECURITIES AND EXCHANGE BOARD OF INDIA (SEBI): ROLE AND FUNCTIONS

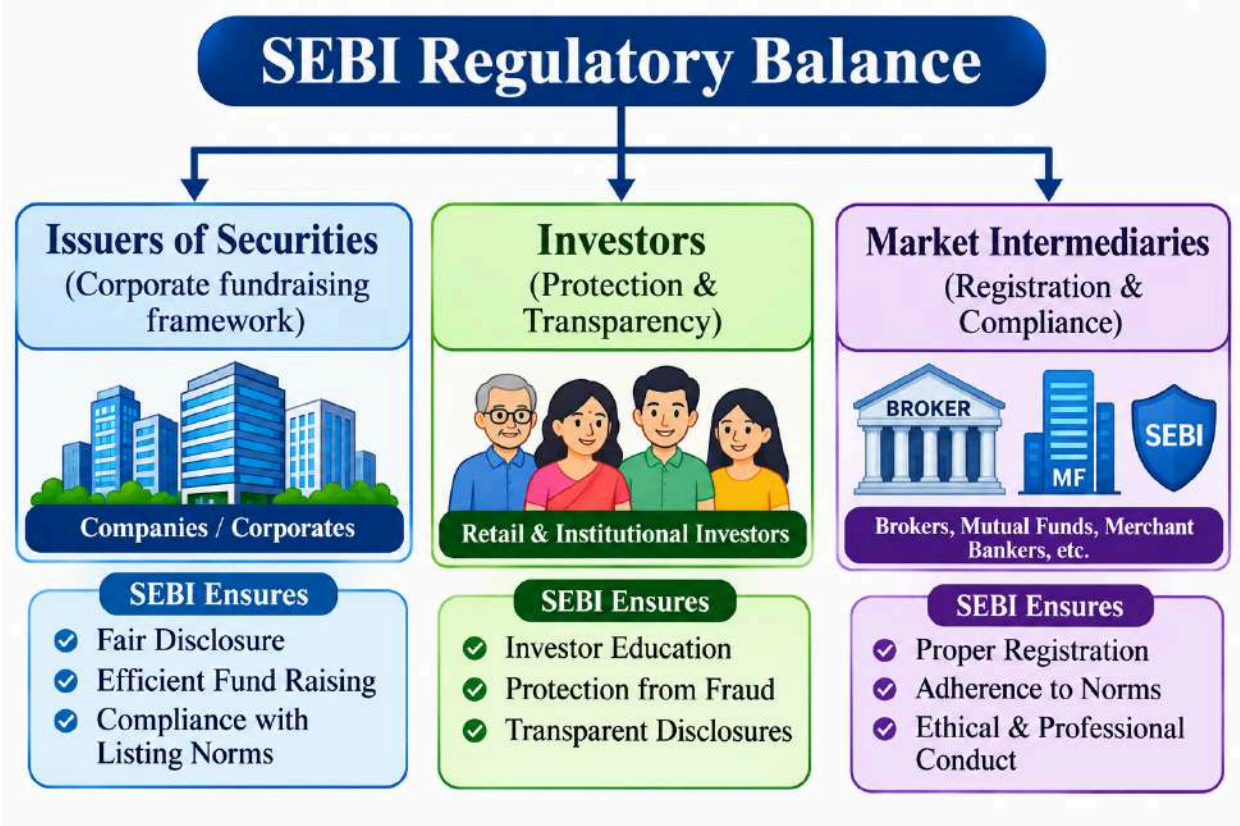
3.1 Institutional Establishment and Regulatory Mandate

The Securities and Exchange Board of India (SEBI) was initially established in 1988 as a non-statutory executive body and subsequently elevated to full autonomous statutory regulator status through the enactment of the **Securities and Exchange Board of India Act, 1992**.

Headquartered in Mumbai, SEBI's mandate is to protect investor interests, regulate capital market operations, prevent unfair trade practices, and promote the orderly growth of the Indian securities market.

3.2 Operational Role of SEBI

SEBI acts as an independent market supervisor, balancing the interests of three key constituency groups:

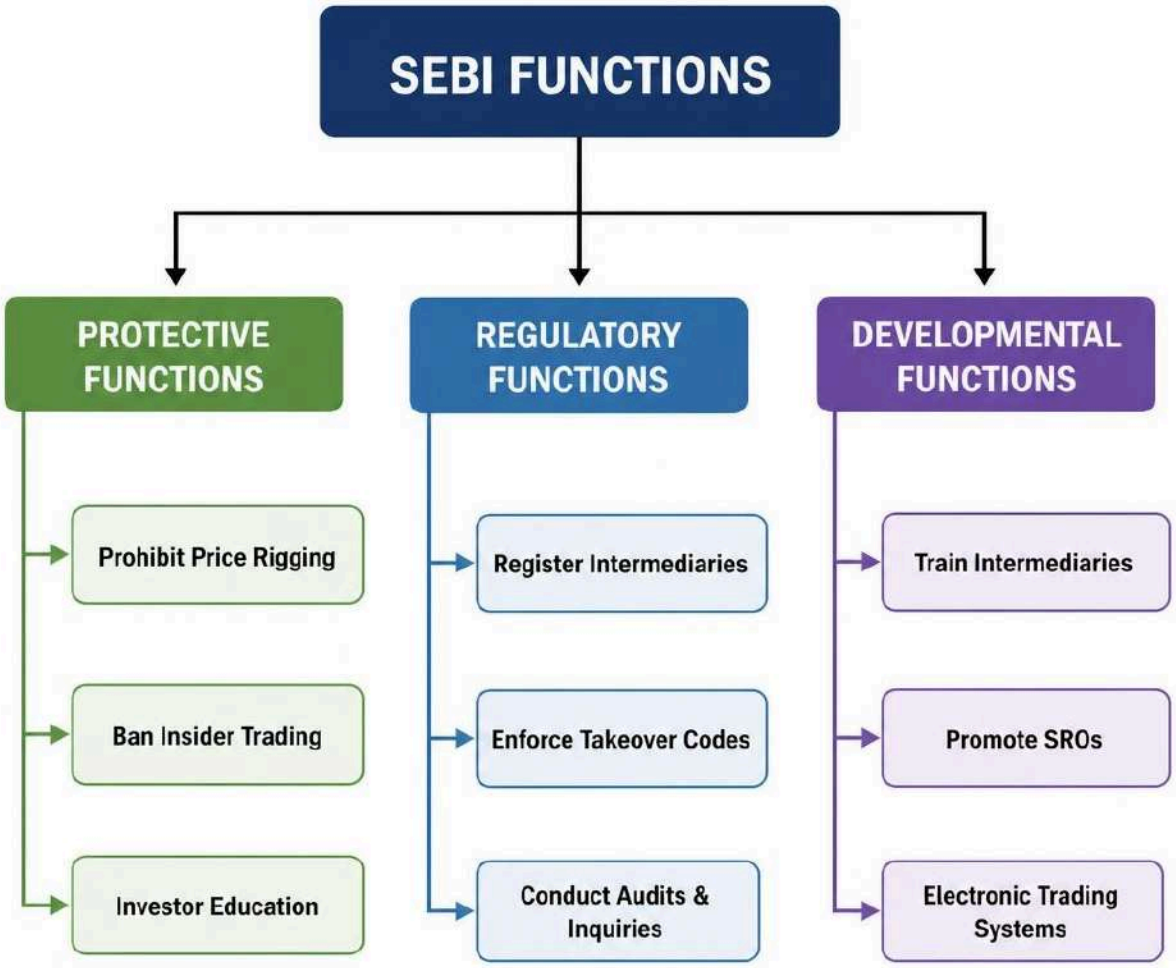


Issuers of Securities: Establishing fair, transparent, and standardized rules for raising equity and debt capital via public offerings, rights issues, and private placements.

1. **Investors:** Safeguarding retail and institutional investors against market manipulation, price rigging, financial fraud, and insider trading while establishing accessible grievance redressal frameworks (e.g., SCORES).
2. **Market Intermediaries:** Registering, monitoring, auditing, and regulating stockbrokers, merchant bankers, underwriters, registrars, depositories, credit rating agencies, and fund managers to ensure ethical conduct.

3.3 Statutory Functions of SEBI

SEBI executes its regulatory mandate through three functional areas:



1. Protective Functions

- **Prohibition of Fraudulent Practices:** Detecting and penalizing unfair trade practices, including price rigging, circular trading, and artificial volume manipulation.
- **Prevention of Insider Trading:** Enforcing the SEBI (Prohibition of Insider Trading) Regulations to prevent corporate insiders, key managerial personnel (KMP), and connected entities from trading on Non-Public Price-Sensitive Information (UPSI).
- **Investor Awareness Campaigns:** Administering nationwide investor education initiatives, financial literacy drives, and operating the SEBI Complaints Redress System (SCORES).

2. Regulatory Functions

- **Framing Disclosure Guidelines:** Formulating guidelines under the SEBI (Issue of Capital and Disclosure Requirements) Regulations (ICDR) and SEBI (Listing Obligations and Disclosure Requirements) Regulations (LODR).
- **Intermediary Governance:** Registering, licensing, establishing net-worth criteria, and enforcing mandatory codes of conduct for stockbrokers, sub-brokers, merchant bankers, underwriters, custodians, and credit rating agencies.
- **Takeover Code Regulation:** Supervising major corporate equity acquisitions, open offers, and corporate takeovers through the SEBI (Substantial Acquisition of Shares and Takeovers) Regulations.
- **Audit & Inspection:** Conducting regular compliance audits, formal inquiries, surprise inspections, and enforcement proceedings against registered market intermediaries and listed companies.

3. Developmental Functions

- **Market Infrastructure Modernization:** Facilitating the transition from physical pit trading to nationwide automated screen-based trading systems (NEAT, BOLT) and implementing shortened settlement cycles (moving from T+5 down to T+1 and T+0).
- **Intermediaries Professionalization:** Promoting training modules and mandatory certifications via the National Institute of Securities Markets (NISM).
- **Self-Regulatory Organizations (SROs):** Encouraging and regulating SROs to foster industry-level self-governance and code compliance.

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4. OVERVIEW OF FOREIGN (INTERNATIONAL) FINANCIAL MARKETS

1. Meaning and Scope of Foreign Markets

Foreign (or international) financial markets refer to global capital, currency, and debt platforms operating outside the domestic legal jurisdiction of an enterprise or investor. These markets connect national financial systems, allowing cross-border capital movements, international trade financing, multi-currency corporate borrowings, and portfolio diversification.

For instance, when an Indian corporation issues **American Depository Receipts (ADRs)** in New York, floats **Masala Bonds** in London, or accesses Eurocurrency credit facilities, it operates within the international financial market.

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2. Strategic Importance of International Financial Markets

1. **International Trade Settlement:** Provides clearing infrastructure, currency conversion networks, and documentary credit (Letters of Credit) for import-export transactions.
2. **Access to Deep Capital Pools:** Enables corporate firms and sovereign governments to raise multi-billion-dollar long-term loans at lower interest rates than domestic markets offer.
3. **Cross-Border Risk Diversification:** Enables institutional portfolio managers to allocate capital across diverse geographical markets, neutralizing localized economic downturns.
4. **Exchange Rate Price Discovery:** Facilitates continuous trading in sovereign currencies, establishing transparent, market-driven exchange rates based on international trade balance and interest rate parity.
5. **Global Risk Hedging:** Offers international derivative structures (currency futures, cross-currency interest rate swaps) to manage currency risks and international interest rate volatility.

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3. Key Segments of International Financial Markets

- **Foreign Exchange (FX) Market:** A decentralized 24/7 global OTC network where sovereign currencies are traded continuously among central banks, commercial institutions, hedge funds, and multinational corporations.
- **International Money Market:** A venue for short-term cross-border debt instruments, liquidity management, and international working capital funding (e.g., Euro-commercial paper, Euro-certificates of deposit).
- **International Capital Market:** A marketplace for raising long-term international equity and debt capital via instruments such as **Eurobonds**, **Foreign Bonds** (e.g., Yankee Bonds, Samurai Bonds), **Global Depository Receipts (GDRs)**, and **American Depository Receipts (ADRs)**.
- **International Credit Market:** Bank-syndicated lending networks providing multi-currency term credit, project financing, and cross-border commercial loans.
- **International Derivatives Market:** Regulated exchanges and OTC networks trading cross-border financial futures, currency options, credit default swaps (CDS), and interest rate swaps.

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4. Classification of Foreign Exchange and Derivative Markets

1. **Spot Market:** Financial platform for purchasing or selling foreign currencies or assets with immediate delivery and physical settlement, typically executed on a **T+2 business day** standard.

2. **Forward Market:** A customized bilateral OTC contract obligating parties to buy or sell a fixed amount of currency at a specified exchange rate on a designated future date.
3. **Futures Market:** A centralized, exchange-traded venue dealing in highly standardized contracts to purchase or sell benchmark assets or currencies on set future dates, managed through daily mark-to-market margin settlement.
4. **Options Market:** A specialized market offering contracts that grant the buyer the right—without legal obligation—to purchase (Call Option) or sell (Put Option) a specified financial asset at a fixed exercise price on or before a specified date, in exchange for an upfront premium paid to the option seller/writer.
5. **Swaps Market:** An OTC market where counterparties exchange financial cash flow streams over a specified timeline, such as exchanging fixed interest rate payments for floating interest rate payments (Interest Rate Swap) or swapping principal and interest payments in different currencies (Currency Swap).

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5. Comparative Matrix of Foreign Market Instruments

Instrument Feature	Spot Market	Forward Market	Futures Market	Options Market	Swaps Market
Primary Objective	Immediate physical currency/asset conversion.	Tailored hedging of specific future exposure dates.	Standardized exchange-traded hedging and speculation.	Asymmetric risk hedging with limited downside exposure.	Restructuring long-term liability costs and cash flows.
Contract Specifics	Standardized spot conventions (T+2 delivery).	Fully customized contract size, rate, and maturity.	Highly standardized contract sizes, dates, and ticks.	Standardized exchange terms or tailored OTC formats.	Customized bilateral financial cash flow streams.
Trading Venue	OTC Interbank Dealer Network.	Bilateral OTC Banking Network.	Centralized Regulated Derivative Exchanges.	Regulated Exchanges or OTC Dealer Network.	Bilateral OTC Dealer Market.
Settlement Obligation	Mandatory settlement by both counterparties.	Mandatory execution by both counterparties.	Obligation to settle or execute offsetting positions.	Buyer holds optionality; Seller faces mandatory performance.	Mandatory periodic cash flow exchange obligations.

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6. Risk Parameters in International Financial Markets

- **Exchange Rate Risk:** Loss exposure arising from sudden, unfavorable shifts in foreign exchange rates prior to transaction settlement.
- **Interest Rate Risk:** Financial volatility resulting from shifts in global benchmark rates (e.g., SOFR, EURIBOR), affecting international debt service costs.
- **Country / Political Risk:** Operational losses caused by sovereign policy shifts, asset expropriation, capital controls, or international trade sanctions.
- **Counterparty Default Risk:** The risk that an overseas financial entity, bank, or corporate buyer defaults on contractual payment or delivery commitments.

- **Global Liquidity Risk:** Inability to liquidate foreign assets quickly without suffering steep market price discounts.

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5. FINANCIAL SECTOR REFORMS IN INDIA

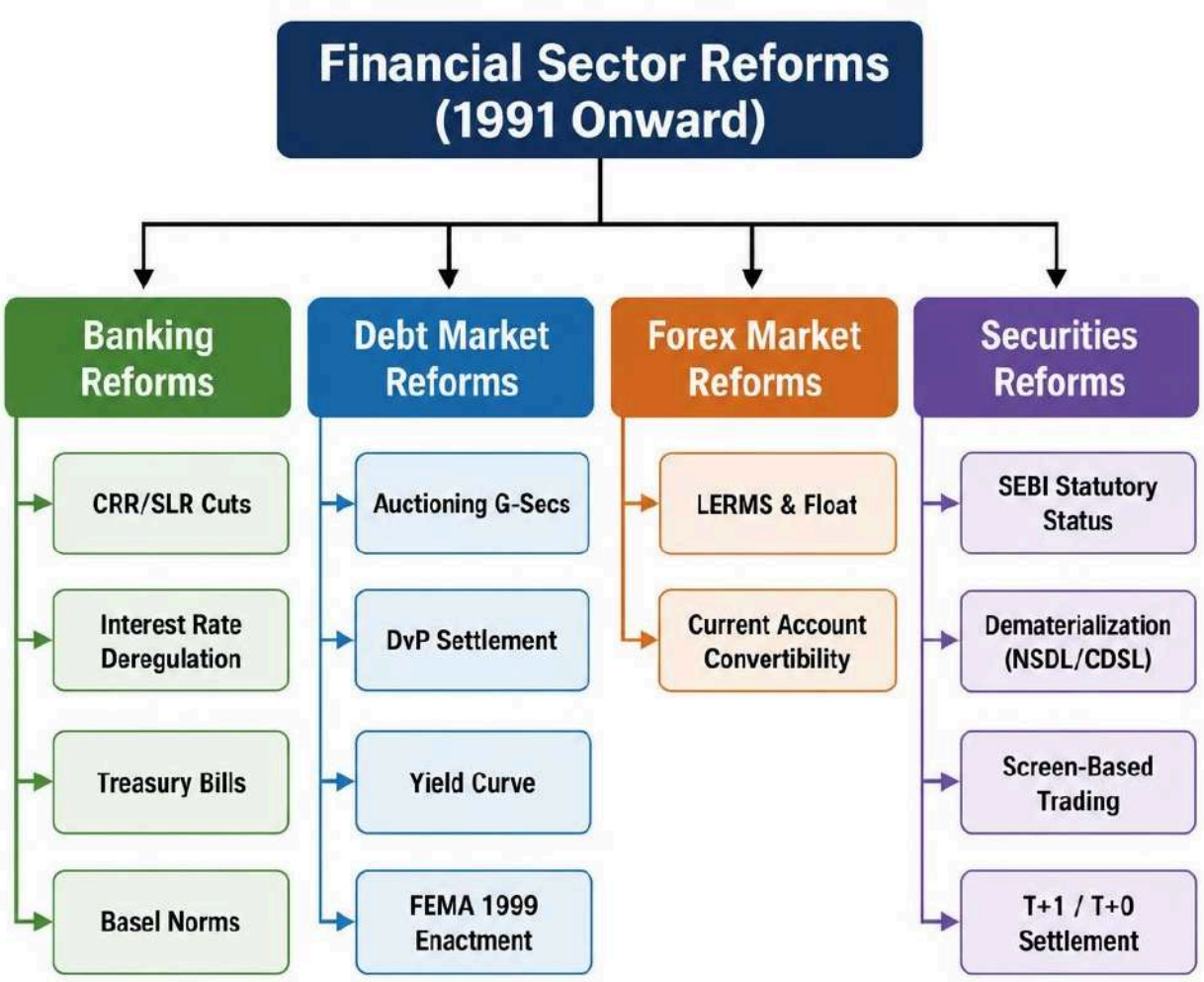
5.1 Background and Imperatives for Economic Reform

Prior to 1991, India's financial architecture was characterized by severe state administrative controls, market fragmentation, lack of competition, and operational inefficiencies:

1. **Pre-Emption of Bank Resources:** Excessive Cash Reserve Ratios (CRR up to 15%) and Statutory Liquidity Ratios (SLR up to 38.5%) pre-empted over 53% of commercial bank deposits toward government borrowing, starving the commercial sector of credit.
2. **Administered Interest Rate Regime:** Deposit and lending rates were administratively fixed by the central bank, distorting capital pricing and market competition.
3. **Severe Entry Barriers:** Private-sector banking licenses were restricted, resulting in public-sector banking monopolies and stagnant customer service standards.
4. **Subordinated Securities Markets:** Capital markets operated via physical open-outcry pits, paper share certificates, settlement delays, frequent counterparty defaults, and lacked statutory regulatory enforcement.
5. **Asset Quality Deterioration:** Inadequate credit appraisal, directed credit allocation, and weak legal recovery frameworks led to systemic non-performing assets (NPAs).

Following the critical 1991 Balance-of-Payments (BoP) crisis, the Government of India instituted structural economic adjustments based on the recommendations of the **Narasimham Committee Reports (Committee on the Financial System - 1991, and Banking Sector Reforms - 1998)**.

5.2 Core Pillars of Financial Sector Reforms



A. Banking Sector Reforms

- **Reduction of Statutory Reserve Ratios:** CRR and SLR were systematically scaled down, freeing up substantial liquidity for commercial lending.
- **Deregulation of Interest Rates:** Commercial banks gained autonomy to price deposit products and extend market-driven lending rates based on their Marginal Cost of Funds-based Lending Rate (MCLR) / External Benchmark Lending Rate (EBLR).

- **Entry of New Private and Foreign Banks:** Banking licenses issued to private entities (e.g., HDFC Bank, ICICI Bank, Axis Bank) introduced technological competition, product innovation, and digital delivery channels.
- **Implementation of Prudential Norms:** Adoption of international **Basel Norms (Basel I, II, III)** mandating standardized income recognition, asset classification (Standard, Sub-standard, Doubtful, Loss assets), loan provisioning, and Capital Adequacy Ratios (CRAR).
- **NPA Resolution Mechanisms:** Institutionalization of enforcement legal frameworks, including the **SARFAESI Act, 2002**, Debt Recovery Tribunals (DRTs), Asset Reconstruction Companies (ARCs), and the **Insolvency and Bankruptcy Code (IBC), 2016**.

B. Debt Market Reforms

- **Market-Based Government Debt Operations:** Ended automatic monetization of fiscal deficits via Ad-hoc Treasury Bills, replacing it with market-determined competitive auctions for Government Securities (G-Secs).
- **Yield Curve Development:** Introduction of standardized 91-day, 182-day, and 364-day Treasury Bills established a short-term benchmark money market yield curve.
- **Delivery-versus-Payment (DvP) Mechanism:** Implementation of electronic DvP systems linked security transfers directly to concurrent cash clearing, eliminating counterparty settlement risks.
- **Infrastructure Modernization:** Introduction of the Negotiated Dealing System-Order Matching (NDS-OM) automated trading platform and establishing the **Clearing Corporation of India Limited (CCIL)** as a central counterparty.

C. Foreign Exchange Market Reforms

- **Market-Determined Exchange Rates:** Transitioned from a fixed pegged exchange rate to the **Liberalised Exchange Rate Management System (LERMS)** in 1992, establishing a market-driven, managed floating exchange rate regime.
- **Current Account Convertibility:** Adopted full current account convertibility in 1994 under Article VIII of the International Monetary Fund (IMF) charter, allowing unrestricted currency conversion for international trade and service payments.
- **Enactment of FEMA, 1999:** Repealed the draconian Foreign Exchange Regulation Act (FERA), replacing it with the **Foreign Exchange Management Act (FEMA), 1999**, shifting regulatory focus from criminal control to external trade facilitation.
- **FX Risk Derivatives Introduction:** Permitted corporate market participants to trade currency forwards, futures, and options to manage foreign exchange volatility.

D. Securities Market Reforms

- **Statutory Status to SEBI:** Granted autonomous statutory enforcement powers to SEBI under the SEBI Act, 1992.

- **Screen-Based Automated Trading:** Replaced floor open-outcry trading with automated, nationwide electronic screen-based trading systems (NSE's NEAT and BSE's BOLT).
- **Dematerialization and Depositories Establishment:** Enacted the **Depositories Act, 1996**, creating National Securities Depository Limited (NSDL) and Central Depository Services (India) Limited (CDSL), converting physical share certificates into electronic demat accounts.
- **Rolling Settlement Cycles Compression:** Shifted trade settlement cycles from multi-week settlement periods down to T+2, T+1, and phased T+0 settlements backed by Settlement Guarantee Funds (SGF).

5.3 Impact of Reforms on the Indian Economy

1. **Financial Deepening:** Aggregated domestic household savings into structured capital market investments, mutual funds, and commercial bank deposits.
2. **Capital Market Modernization:** Established the Indian equity market as one of the world's most technologically advanced, liquid, and transparent venues, drawing billions in Foreign Portfolio Investment (FPI).
3. **Resilient Banking System:** Enhanced commercial bank capital buffers, provisioning coverage ratios, and capital adequacy standards against macroeconomic shocks.
4. **Digital Financial Revolution:** Led global payment innovations through electronic clearing, RTGS, NEFT, and the **Unified Payments Interface (UPI)**.

5.4 Ongoing Challenges and Limitations

- **Stressed Assets & Cyclical NPAs:** Commercial banks remain vulnerable to corporate debt defaults, requiring continuous monitoring and provisioning.
- **Last-Mile Financial Inclusion Gaps:** Expanding affordable, credit facilities to rural agriculturalists, micro-enterprises, and marginalized demographics remains an ongoing priority.
- **Cybersecurity Threats:** Deep digital banking adoption increases system vulnerability to online financial fraud, malware attacks, and systemic data breaches.
- **Financial Literacy Deficits:** Complex modern financial products demand continuous investor awareness programs to insulate retail investors from market fraud and high-risk investments.

UNIT – II: BANKING, INSURANCE, CAPITAL MARKET INTERMEDIARIES, AND MERCHANT BANKING

1. OVERVIEW OF BANKING AND INSURANCE SERVICES

1.1 Institutional Role of Banking in Economic Development

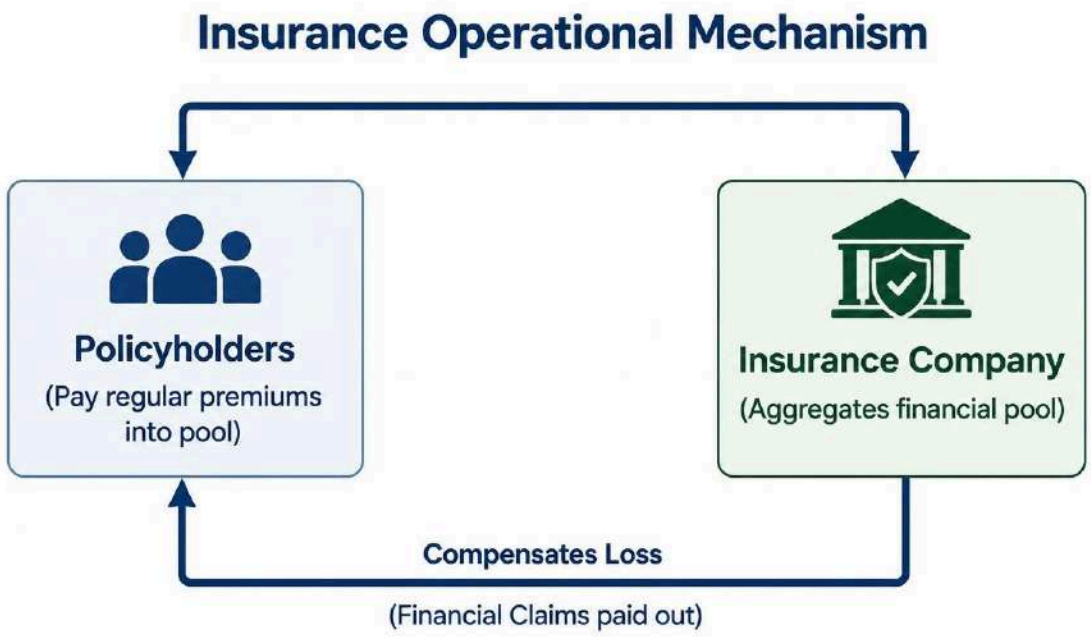
The banking sector constitutes the principal monetary intermediary of an economy. Commercial and cooperative banks mobilize deposits from savings-surplus households, extend commercial loans to business enterprises, provide payment clearing facilities, and implement monetary policy transmissions directed by the central bank.

Beyond credit allocation, modern banking services provide financial settlement systems, liquidity management, international trade financing (Letters of Credit, Bill Discounting), and digital transaction mechanisms that sustain commercial activity.

1.2 Insurance Services: Concept, Principles, and Framework

A. Definition and Mechanism of Insurance

Insurance is a risk-transfer financial contract (policy) wherein an institutional risk-bearing entity (the insurer/underwriter) agrees to indemnify another party (the insured/policyholder) against specified financial losses resulting from unpredictable future contingencies, in exchange for a consideration called a **premium**.



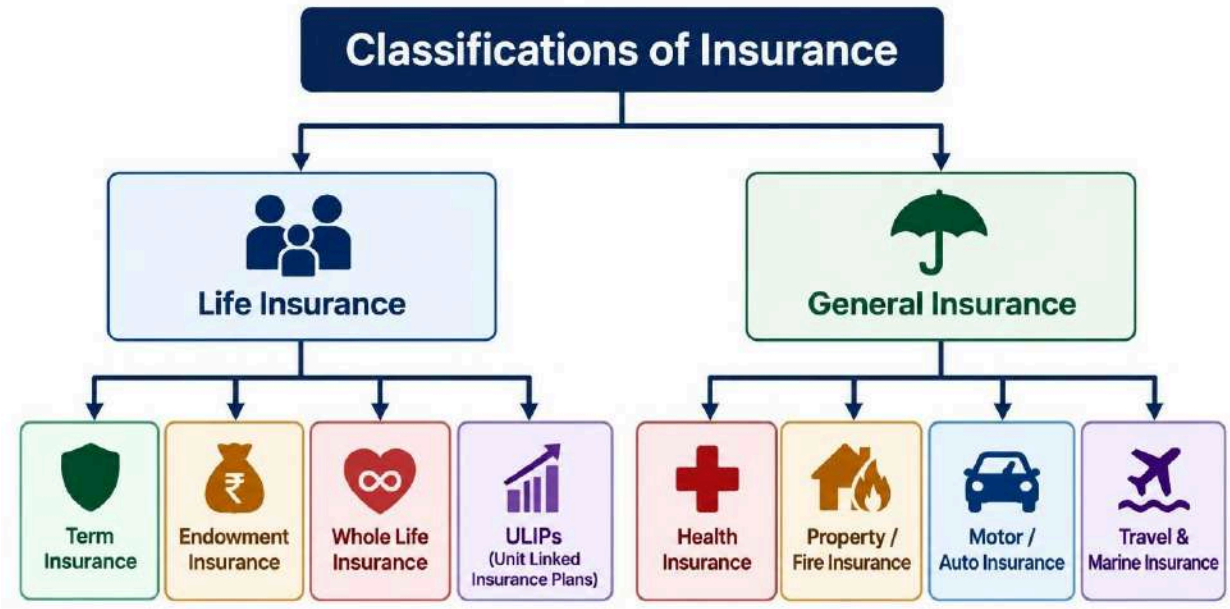
The underlying operational mechanism relies on the Law of Large Numbers and Risk Pooling. By aggregating financial contributions (premiums) from a large pool of policyholders facing similar operational or physical risks, the insurer can pay out claim compensation to the few individuals or firms who actually suffer covered financial losses during the policy period.

B. Fundamental Principles of Insurance

1. **Principle of Utmost Good Faith (*Uberrimae Fidei*):** Both the policyholder and insurer must fully disclose all material facts affecting the insured risk without misrepresentation or concealment.
2. **Principle of Insurable Interest:** The insured must possess a legally recognized financial interest in the preservation of the subject matter of insurance, suffering financial loss upon its destruction or damage.
3. **Principle of Indemnity:** Applicable to non-life general insurance; the insurer undertakes to restore the insured to the exact financial position held immediately prior to the loss, preventing policyholders from profiting from insurance claims.
4. **Principle of Subrogation:** Upon fully compensating the policyholder's financial claim, the insurer steps into the legal shoes of the insured to pursue legal recovery against third parties responsible for the damage.
5. **Principle of Proximate Cause (*Causa Proxima*):** Claims are payable only if the direct, dominant, and proximate cause of the loss is an insured peril specified within the contract terms.

6. **Principle of Contribution:** If an asset is insured across multiple general insurance carriers, each insurer contributes proportionally to the loss, preventing double recovery by the insured.

1.3 Classifications of Insurance Coverage



Life Insurance: Long-term financial contracts compensating named beneficiaries upon the death of the life assured, or paying maturity benefits upon surviving the policy term. Product variants include Term Assurance, Endowment Plans, Whole Life Policies, and Unit-Linked Insurance Plans (ULIPs).

1. **Health Insurance:** Financial contracts covering medical expenditures, hospitalization costs, surgical procedures, and critical illness treatments incurred by the insured.
2. **Property and Fire Insurance:** Indemnifies real estate, factory buildings, machinery, and inventory against damage caused by natural disasters, accidental fires, floods, explosions, or civil unrest.
3. **Motor/Auto Insurance:** Mandatory statutory coverage (under the Motor Vehicles Act) providing third-party liability compensation for bodily injury or property damage, alongside optional "own-damage" protection for vehicles.
4. **Travel and Marine Cargo Insurance:** Covers transit-related risks, including international voyage cargo losses, flight delays, medical emergencies abroad, and lost baggage.

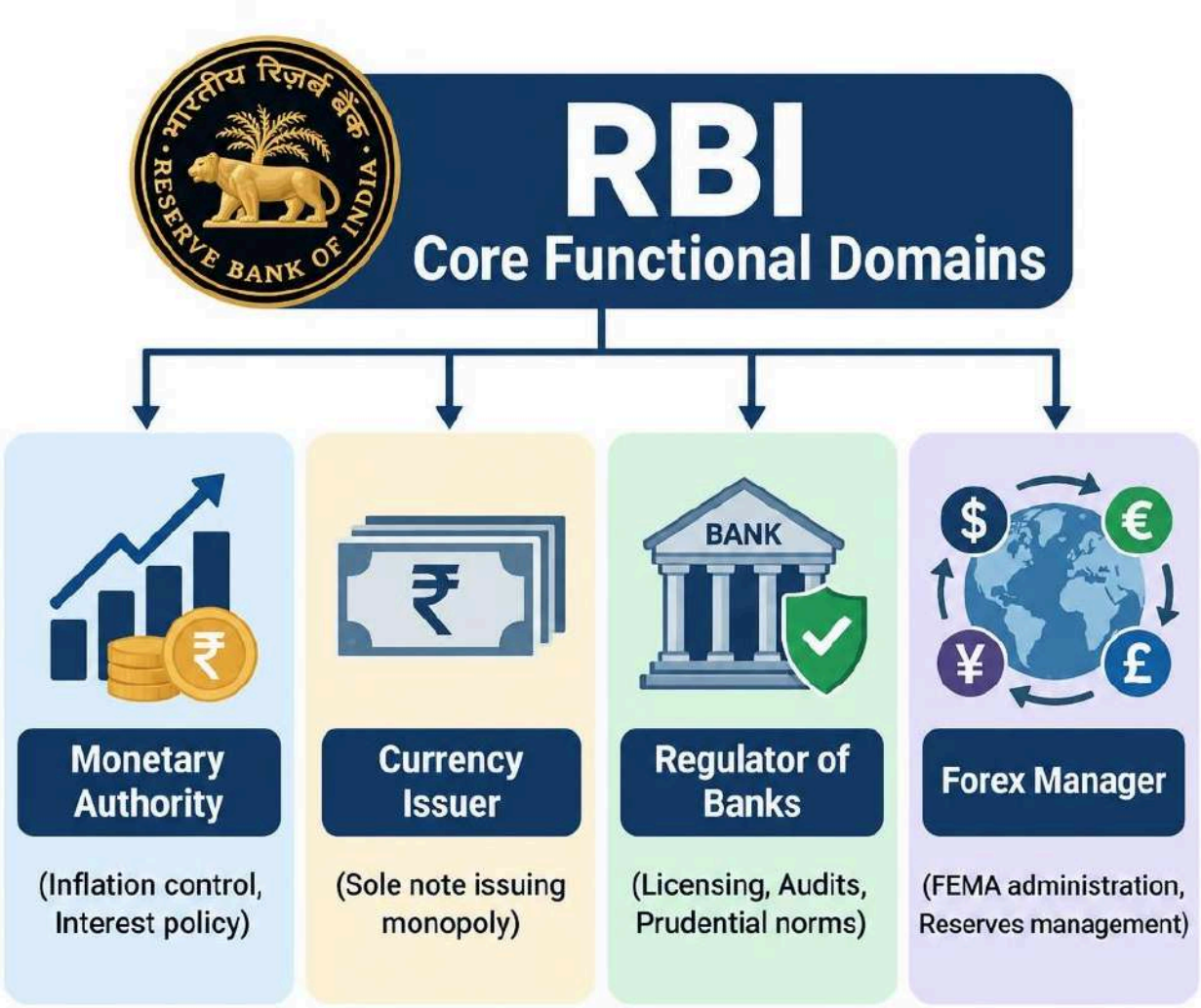
2. RESERVE BANK OF INDIA (RBI): ROLE AND FUNCTIONS

2.1 Statutory Profile and Preamble

Established on April 1, 1935, under the **Reserve Bank of India Act, 1934**, and nationalized in 1949, the RBI is India's central monetary authority.

The statutory preamble of the RBI mandates it to:

> *"Regulate the issue of Banknotes and keeping of reserves with a view to securing monetary stability in India and generally to operate the currency and credit system of the country to its advantage."*



2.2 Core Functions of the RBI

1. Sole Note Issuing Authority

The RBI holds an absolute statutory monopoly over the issuance of currency notes in India (excluding one-rupee notes and coins, which are issued by the Ministry of Finance but circulated via the RBI). Currency notes are legal tender backed by gold reserves, foreign sovereign securities, and Government of India bonds under the **Minimum Reserve System**.

2. Banker to the Central and State Governments

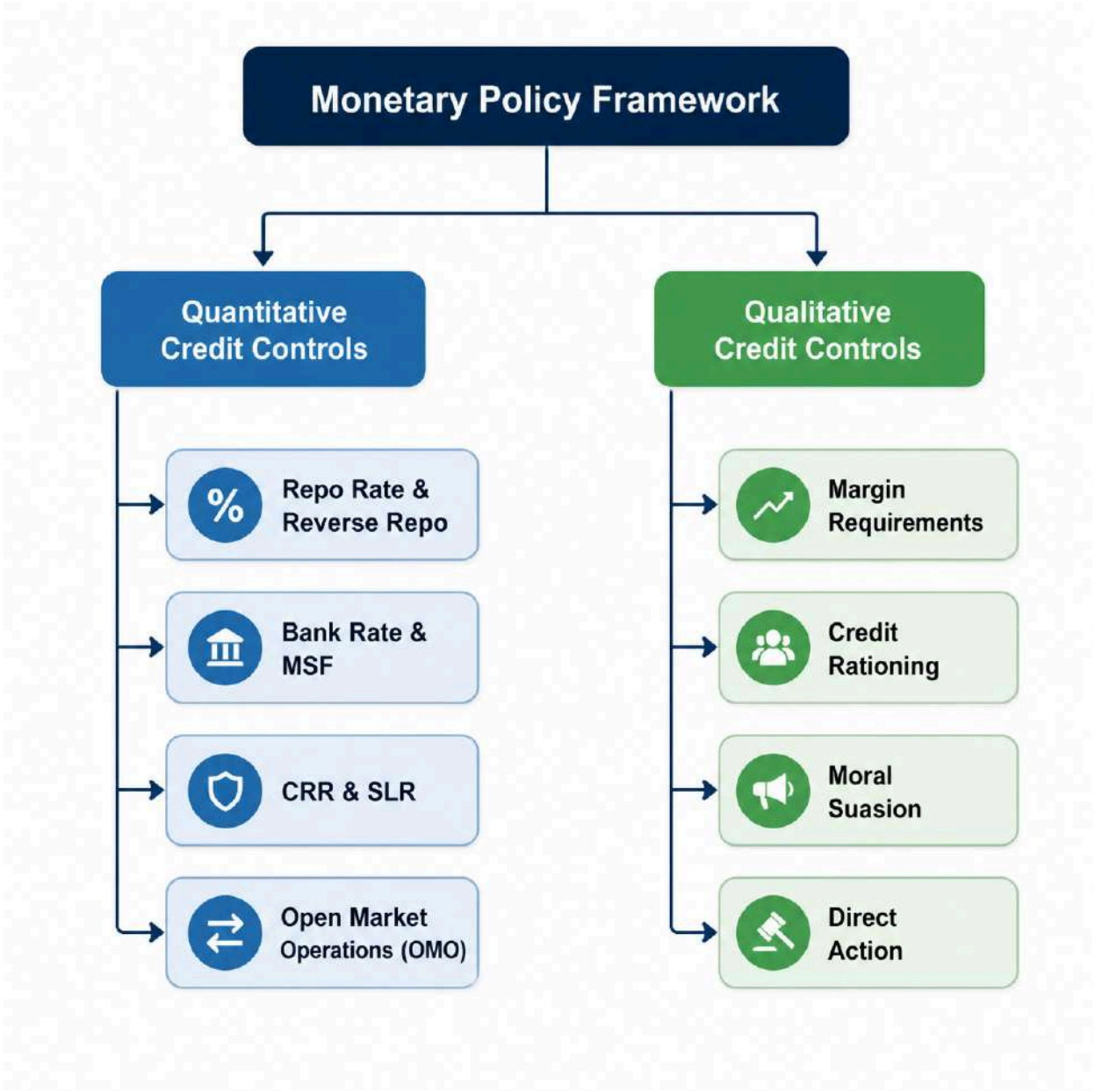
- Conducts public debt management operations, issuing Treasury Bills and dated Government Securities.
- Maintains government transaction accounts, receiving revenues and executing public disbursements.
- Grants short-term credit liquidity to central and state governments through **Ways and Means Advances (WMA)** to manage temporary cash flow mismatches.
- Acts as financial advisor to the sovereign on macroeconomic, fiscal, and debt strategies.

3. Banker to Commercial Banks & Lender of Last Resort

- Maintains statutory cash reserves of commercial banks (Cash Reserve Ratio - CRR).
- Operates centralized payment clearing and interbank settlement systems (RTGS, NEFT, Clearing House management).
- Functions as the **Lender of Last Resort**, offering emergency credit facilities to solvent commercial banks facing temporary liquidity distress against eligible securities.

4. Controller of Money Supply and Credit

The RBI deploys **Quantitative** and **Qualitative** monetary tools to maintain price stability while supporting economic growth:



Quantitative Tools:

- **Repo Rate:** The key policy rate at which the RBI lends short-term funds to commercial banks against government collateral.
- **Reverse Repo Rate:** The interest rate at which commercial banks park surplus liquidity with the RBI.
- **Cash Reserve Ratio (CRR):** Mandatory percentage of Net Demand and Time Liabilities (NDTL) banks must deposit as cash with the RBI.
- **Statutory Liquidity Ratio (SLR):** Mandatory percentage of NDTL banks must maintain in approved liquid assets (G-Secs, Gold, Cash).

    - **Open Market Operations (OMOs):** Outright purchase or sale of government securities in the open market to expand or contract system liquidity.
- **Qualitative/Selective Tools:**
    - **Margin Requirements:** Adjusting loan-to-value (LTV) ratios to curb speculative borrowing.
    - **Moral Suasion:** Issuing policy directives and persuasive communications to bank leadership to align lending behavior with monetary goals.
    - **Direct Action:** Imposing administrative penalties or business restrictions on non-compliant financial institutions.

5. Supervisory Regulator of the Banking System

Exercising statutory powers under the **Banking Regulation Act, 1949**, the RBI issues banking licenses, approves branch expansions, enforces corporate governance standards, conducts periodic inspections (CAMELS framework), and mandates minimum capital standards (Basel III).

6. Management of Foreign Exchange Reserves

Administers the Foreign Exchange Management Act (FEMA), 1999, intervenes in foreign exchange markets to smooth currency volatility, and manages India's foreign exchange reserves (foreign currency assets, gold, Special Drawing Rights - SDRs).

2.3 Promotional and Developmental Role of the RBI

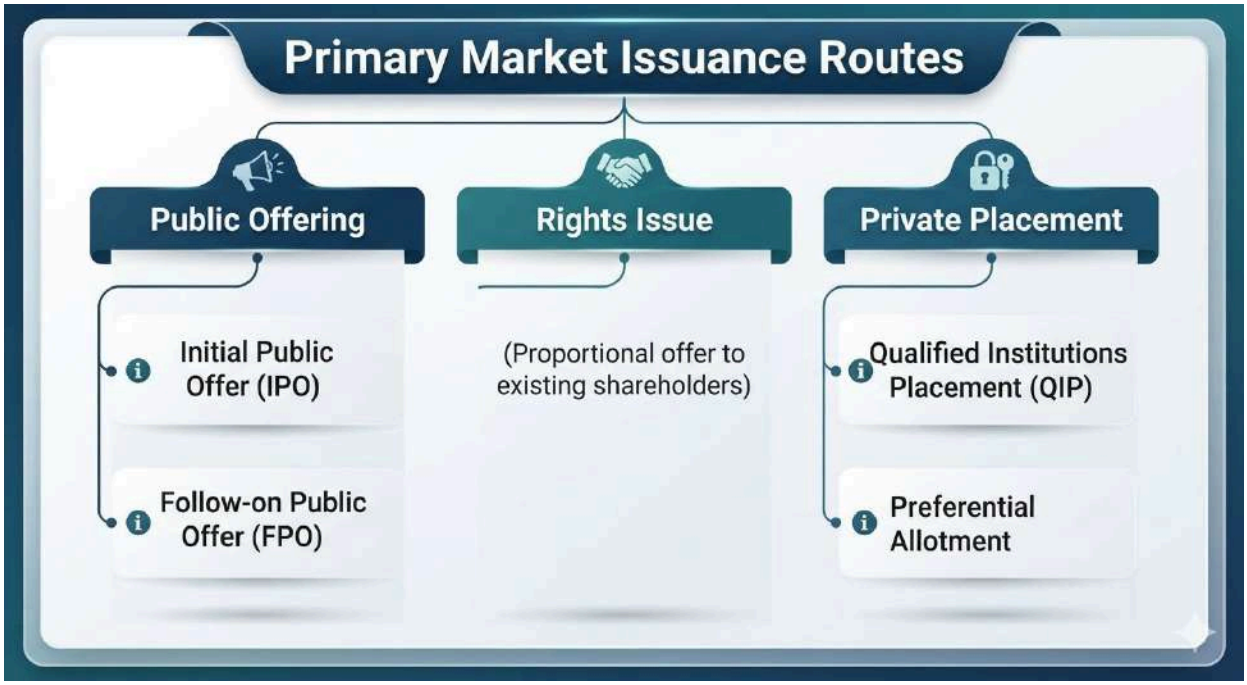
- **Agricultural Credit Architecture:** Established specialized institutions like the **National Bank for Agriculture and Rural Development (NABARD)** and mandated Priority Sector Lending (PSL) targets (40% of credit for agriculture, MSMEs, weaker sections).
- **Industrial Credit Infrastructure:** Promoted specialized development institutions, including IDBI, SIDBI, IFCI, and EXIM Bank, to supply long-term industrial capital.
- **Financial Inclusion & Digitalization:** Spearheaded basic banking access (PMJDY accounts), introduced Payment Banks and Small Finance Banks, and built modern digital infrastructure (UPI, Central Bank Digital Currency - CBDC/Digital Rupee).

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3. PRIMARY AND SECONDARY MARKETS AND THEIR INTERMEDIARIES

3.1 Primary Market: Structure and Methods of Capital Raising

The primary market deals with the creation and initial issuance of new equity or debt securities by corporate entities, financial institutions, and sovereign authorities to raise fresh capital.



Principal Methods of Raising Capital in Primary Markets:

1. **Initial Public Offering (IPO):** The process where an unlisted corporate firm issues equity shares to the public for the first time, transforming into a publicly listed company on stock exchanges.
2. **Follow-on Public Offering (FPO):** Public offering of additional equity shares by a company that is already publicly listed.
3. **Rights Issue:** Offer of additional shares made exclusively to existing equity shareholders in proportion to their existing holdings on a specified record date.
4. **Private Placement:** Issuance of securities directly to a select group of institutional or accredited investors (not exceeding 200 persons in a financial year under Indian Company Law) without issuing a public prospectus.
5. **Qualified Institutions Placement (QIP):** A streamlined private placement mechanism where a listed corporate firm issues equity shares or convertible securities exclusively

to **Qualified Institutional Buyers (QIBs)** like mutual funds, insurance firms, and foreign portfolio investors under SEBI regulations.

6. **Preferential Allotment:** Allotment of equity shares or convertible warrants to specific strategic investors on a preferential basis, subject to strict SEBI pricing and lock-in norms.

3.2 Secondary Market: Structure and Trading Mechanisms

The secondary market provides an organized trading infrastructure where investors buy and sell previously issued securities among themselves. Transactions in the secondary market redistribute security ownership without affecting the total share capital of the original issuing corporation.

Key Differences Between Primary and Secondary Markets:

Operational Parameter	Primary Market	Secondary Market
Nature of Securities	Freshly issued securities (New Issues).	Previously issued securities (Second-hand trading).
Issuing Entity Involvement	Direct participation; issuer receives sales proceeds.	No direct participation; proceeds flow between investors.
Price Determination	Fixed price or determined via Book Building band.	Continuous market-driven price discovery via supply/demand.
Financial Location	Virtual/Documentary (Prospectus, Offer applications).	Centralized Stock Exchanges (NSE, BSE, OTC networks).
Capital Formation Impact	Directly expands corporate physical capital formation.	Indirect impact; provides asset liquidity and valuation benchmarks.

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4. STOCK EXCHANGES IN INDIA: BSE, NSE, AND OTCEI

4.1 Overview of Stock Exchanges

A stock exchange is an organized financial venue where listed securities (equity shares, debentures, exchange-traded funds, derivatives) are traded under standardized exchange rules, legal statutes, and automated market clearing systems.

4.2 Bombay Stock Exchange (BSE)

Established in 1875 as the *"Native Share and Stock Brokers' Association"* at Dalal Street, Mumbai, the BSE is Asia's oldest stock exchange.

Key Characteristics and Functions:

- **Benchmark Equity Index:** The **S&P BSE SENSEX**, comprising 30 financially sound, highly liquid, market-capitalization-weighted stocks across key industrial sectors.
- **Electronic Trading Engine:** Transited from floor open-outcry pit trading to the **BOLT** (BSE On-Line Trading) electronic platform in 1995.
- **Corporate Listing Venue:** Holds one of the world's largest listings of corporate entities (over 5,000 listed firms).

4.3 National Stock Exchange of India (NSE)

Incorporated in 1992 and commencing operations in 1994, the NSE was established as a demutualized, technology-driven nationwide stock exchange to modernize Indian capital markets.

Key Innovations and Features:

- **Benchmark Equity Index:** The **NIFTY 50**, tracking 50 diversified blue-chip stocks representing major sectors of the economy.
- **Automated Screen-Based Trading:** Pioneered the **NEAT** (National Exchange for Automated Trading) nationwide satellite-linked order-matching engine.
- **Derivatives Market Leadership:** World's largest exchange by trading volume in equity options and futures.
- **Demutualization Structure:** Separated exchange ownership, management, and trading rights to eliminate broker conflicts of interest.

4.4 Over the Counter Exchange of India (OTCEI)

Established in 1990 under the Companies Act and recognized under the SCRA in 1989, OTCEI was designed to provide small and medium enterprises (SMEs) access to capital markets without incurring steep traditional listing expenses.

Structural Innovations & Historical Relevance:

- Introduced key market structures to India, including **Sponsorship of Companies**, **Market Making** (two-way buy/sell dealer quotes), and electronic scripless trading.
- *Regulatory Status Clarification:* Following market consolidation toward BSE and NSE, OTCEI fell out of commercial favor. SEBI officially permitted OTCEI to exit as a recognized stock exchange via an official exit order dated **March 31, 2015**. It remains an important historical case study in market structure evolution.

4.5 Comparative Matrix: BSE vs. NSE vs. OTCEI

Comparison Feature	Bombay Stock Exchange (BSE)	National Stock Exchange (NSE)	OTCEI (Historical)
Year of Inception	1875 (Asia's oldest exchange).	1992 (Commenced operations 1994).	1990 (Exited market 2015).
Benchmark Index	S&P BSE SENSEX (30 Stocks).	NIFTY 50 (50 Stocks).	No major benchmark index.
Market Ownership	Demutualized Public Limited Entity.	Demutualized Institutional Holdings.	Sponsored Joint Venture.
Target Issuers	Large, Mid, Small Capitalization Firms.	Large, Mid Capitalization Firms & Derivatives.	Emerging Small-Medium Enterprises (SMEs).
Trading System	BOLT (BSE On-Line Trading).	NEAT (National Exchange Automated Trading).	Ringless Dealer OTC Network.
Current Operational Status	Fully Active Operating Exchange.	Fully Active Operating Exchange.	Officially Exited Stock Exchange (2015).

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5. MERCHANT BANKING SERVICES AND NEW ISSUE MANAGEMENT

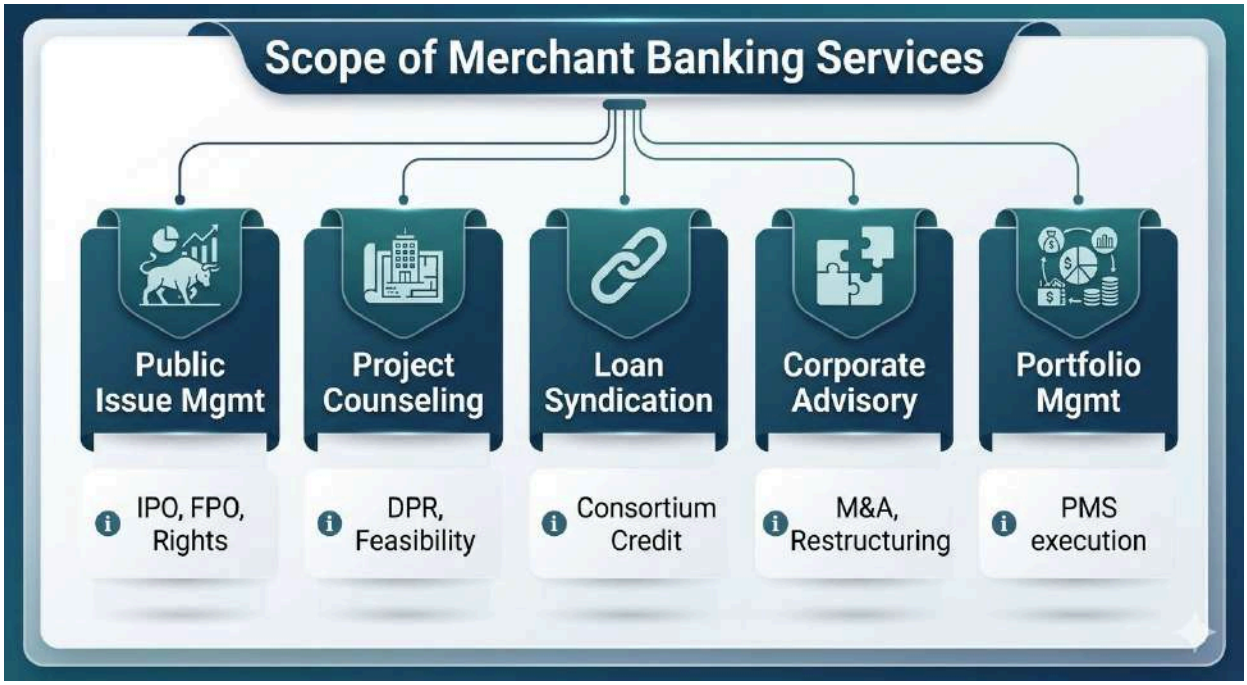
5.1 Definition and Role of Merchant Banking

Merchant banking represents a specialized non-banking financial service providing corporate financial advisory, public issue management, loan syndication, portfolio management, and strategic corporate restructuring to businesses.

Under the **SEBI (Merchant Bankers) Regulations, 1992**, a merchant banker is defined as:

> *"Any person who is engaged in the business of issue management either by making arrangements regarding selling, buying or subscribing to securities or acting as manager, consultant, advisor or rendering corporate advisory service in relation to such issue management."*

In India, Category-I Merchant Bankers hold mandatory authorization to act as Lead Managers for public capital issues.



5.2 Core Operational Services Offered by Merchant Banks

1. **New Issue Management:** Structuring, pricing, managing legal compliance, and underwriting corporate security issues.

2. **Project Counseling & Appraisal:** Assisting entrepreneurs in preparing Detailed Project Reports (DPRs), evaluating financial internal rates of return (IRR), and structuring project capital.
3. **Loan Syndication:** Arranging large multi-bank consortium loans and credit term facilities for infrastructure or industrial capital expenditure.
4. **Corporate Restructuring & M&A Advisory:** Advising management on corporate spin-offs, strategic alliances, buybacks, equity restructurings, and takeover valuation defense.
5. **Debenture and Debt Advisory:** Structuring corporate bonds, evaluating credit rating prerequisites, and appointing trustees.

5.3 New Issue Management Mechanics

New issue management involves coordinating legal, operational, and financial activities to market corporate equity or debt securities to investors.



5.4 Prospectus and Offer Documents

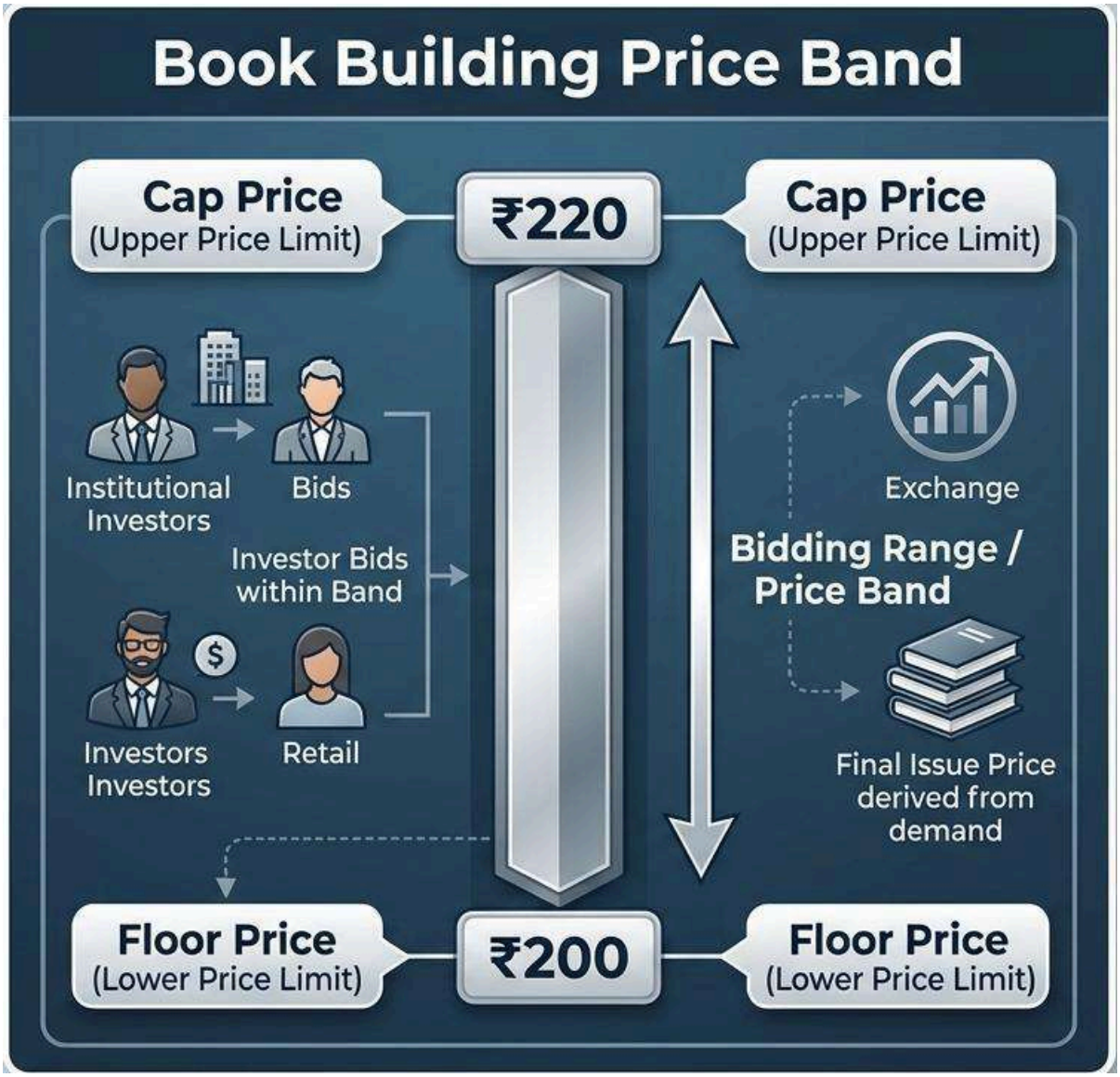
A prospectus is a legal document containing full disclosures regarding an issuing company's operations, financial statements, risk factors, promoter background, and capital requirements, enabling investors to make informed investment decisions.

Types of Offer Documents:

- **Draft Red Herring Prospectus (DRHP):** Preliminary disclosure document filed with SEBI and stock exchanges for public review and regulatory comments prior to pricing.
- **Red Herring Prospectus (RHP):** Offer document containing complete business and financial details but omitting specific issue price or share quantity details, specifying instead a **Price Band**.
- **Fixed Price Prospectus:** Offer document issued when shares are sold at a single, predetermined fixed price.
- **Abridged Prospectus:** A condensed summary of the main prospectus attached to public application forms under Section 33 of the Companies Act, 2013.

5.5 Book Building Process vs. Fixed Price Issue

Book building is a price discovery mechanism where an issuer sets a price band for securities, inviting investors to submit bids specifying the quantity of shares and price they are willing to pay.



Comparative Matrix:

Feature	Fixed Price Issue	Book Building Issue
Issue Price	Known and fixed upfront in the prospectus.	Price discovered dynamically post-bidding.
Price Band	No range provided; single fixed amount.	Floor Price and Cap Price specified (Max 20% spread).
Demand Information	Known only after subscription closes.	Demand built dynamically via daily electronic order books.

Feature	Fixed Price Issue	Book Building Issue
Application Payment	Full payment submitted at application time.	Bids placed via ASBA (Application Supported by Blocked Amount).
Cut-Off Price Option	Not applicable.	Available to Retail Individual Investors (RIIs).

5.6 Green Shoe Option (Over-Allotment Option)

A **Green Shoe Option** is a contractual provision in an underwriting agreement authorizing the lead manager/underwriter to allocate additional shares (up to a statutory maximum of **15%** of the base issue size in India) to investors if a public offer is oversubscribed.



Purpose: Acts as a price-stabilization mechanism post-listing. If market prices drop below the issue price, the stabilizing agent buys shares from the open market to support the stock price. If market prices rise above the issue price, the stabilizing agent exercises the option to acquire shares from promoters at the original issue price to settle over-allotments.

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6. CAPITAL MARKET INTERMEDIARIES AND SPECIALIZED SERVICES

6.1 Underwriting Services

Underwriting is an institutional agreement where an underwriter (merchant bank, financial institution, stockbroker) guarantees to subscribe to an agreed portion or shortfall of securities if the public subscription fails to reach the mandatory minimum threshold (90% in India under SEBI guidelines).

Key Underwriting Variations:

- **Hard Underwriting:** Underwriters accept an absolute commitment upfront to purchase unsubscribed shares regardless of market demand.
- **Soft Underwriting:** Underwriters commit to purchase unsubscribed shares only if subscription shortfalls persist after marketing efforts complete.
- **Syndicated Underwriting:** Group of underwriters pooling financial resources to share large underwriting exposure on major public offerings.

6.2 Registrar and Share Transfer Agents (RTA)

RTAs are specialized SEBI-registered institutions that maintain corporate shareholder ownership registries, process investor applications, manage share dematerialization, execute dividend dispatches, and process corporate actions (bonus shares, stock splits, rights issues).

6.3 Stockbroking

Stockbrokers are licensed SEBI-registered entities that hold trading rights on recognized stock exchanges, executing buy and sell orders on behalf of retail and institutional clients in exchange for brokerage fees.

Broker Typology:

1. **Full-Service Brokers:** Provide comprehensive research reports, investment advisory, portfolio tracking, and trade execution facilities (charge higher brokerage fees).
2. **Discount Brokers:** Offer low-cost, technology-driven electronic trading platforms for execution-only clients without offering research or personal advisory services.
3. **Jobbers/Market Makers:** Independent exchange participants providing continuous two-way buy and sell quotes for specific securities to supply market liquidity.

4. **Arbitrageurs:** Traders capitalizing on simultaneous price discrepancies for an asset across different exchange platforms (e.g., buying a stock on BSE and selling it concurrently on NSE).

6.4 Depositories and Custodial Services

A **Depository** is an apex institution that holds securities (shares, debentures, bonds) in electronic (dematerialized) book-entry form, enabling instantaneous paperless security transfers across investor accounts.

In India, two central depositories operate under the **Depositories Act, 1996**:

1. **NSDL (National Securities Depository Limited)** – Promoted by NSE, IDBI, UTI.
2. **CDSL (Central Depository Services Limited)** – Promoted by BSE, State Bank of India.



Depository Participant (DP): An authorized agent (bank, stockbroker) serving as the operational link between the depository and the retail investor (Beneficial Owner).

- **Custodial Services:** Specialized financial institutions holding physical custody of institutional securities, collecting interest/dividends, executing settlement delivery, and managing corporate actions for institutional funds, Foreign Portfolio Investors (FPIs), and foreign corporate accounts.

6.5 Short Selling and Securities Lending and Borrowing (SLB)

A. Mechanics of Short Selling

Short selling involves selling securities that the seller does not currently own, by borrowing the securities through a registered mechanism, anticipating that the security's market price will decline.



Risk Profile: Traditional long investment positions face a maximum potential loss limited to 100% of invested capital (if asset value hits zero). Short positions carry theoretically unlimited risk exposure because stock market prices can rise indefinitely.

B. Securities Lending and Borrowing (SLB) Scheme

SLB is an authorized SEBI-regulated market platform that enables investors to lend idle securities to short sellers or market participants facing settlement clearing shortfalls, in exchange for an agreed lending fee.

- **Key Features of Indian SLB System:**
    - Automated screen-based order matching operated via National Securities Clearing Corporation Limited (NSCCL) / Indian Clearing Corporation Limited (ICCL).
    - Standardized contract tenures available from 1 month up to 12 months.

- Lenders retain beneficial ownership entitlements (manufactured dividends, corporate actions are passed back to lenders).
- Fully collateralized system requiring margin payments to protect against borrower default risks.

UNIT – III: LEASE FINANCING, HIRE PURCHASE, CONSUMER CREDIT, AND SHORT/MEDIUM-TERM ASSET FINANCING

1. LEASE FINANCING AND TYPES OF LEASES

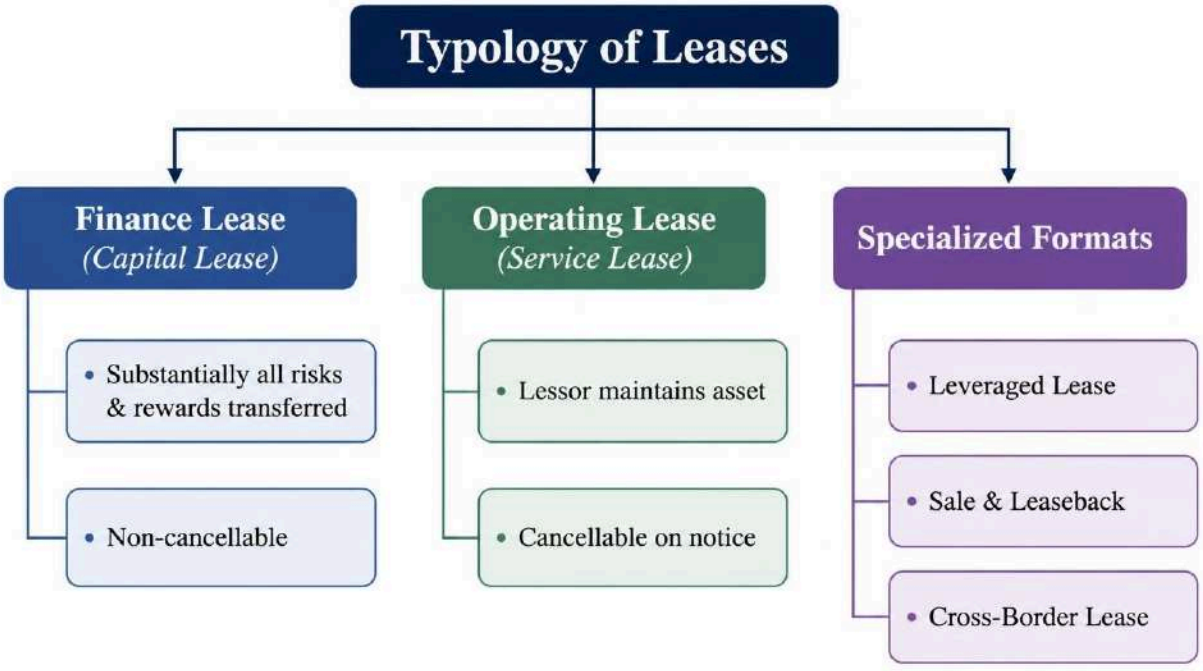
1.1 Concept of Lease Financing

Lease financing is an asset-backed medium- to long-term financing arrangement where the legal owner of an asset (**Lessor**) grants another party (**Lessee**) the right to use the asset for an agreed operational duration in exchange for periodic monetary payments called **Lease Rentals**.



At contract expiry, asset ownership either reverts to the lessor, is renewed under a secondary lease, or is purchased by the lessee under predetermined purchase options.

1.2 Classification of Leases



A. Finance Lease (Capital Lease)

A Finance Lease is a long-term, non-cancellable contract where the lessor transfers substantially all risks, operational responsibilities, maintenance obligations, and economic rewards incidental to legal ownership to the lessee.

- **Primary Features:**
  - Lease term covers most of the asset's economic working lifespan.
  - **Primary Period (Non-Cancellable):** Lease rentals during this initial period allow the lessor to fully amortize the initial capital outlay of the asset plus earn a target financial return.
  - **Secondary Period:** Lessee can renew the lease for a nominal "peppercorn" rental.
  - Lessee is responsible for asset maintenance, property taxes, insurance, and repairs.

B. Operating Lease (Service Lease)

An Operating Lease is a short-term contract where the lessor grants asset usage rights without transferring the ownership risks and economic rewards of the asset.

- **Primary Features:**
    - Lease term is substantially shorter than the asset's total economic lifespan.
    - Lessor provides asset maintenance, insurance, technical updates, and repairs (Service Lease).
    - **Cancellability:** Lessee retains the contractual right to terminate the lease prior to contract expiry by providing short notice.
    - Lessor assumes asset obsolescence risk and relies on re-leasing the asset to multiple successive users to recover total capital outlay.

C. Specialized Lease Structures

1. **Sale and Leaseback:** A corporate entity owning a physical asset (real estate, machinery) sells the asset to a leasing company for immediate cash liquidity and simultaneously leases the asset back to continue seamless business operations.
2. **Leveraged Lease:** Used for high-value assets (aircraft, ships, power plants). The lessor borrows a significant portion (60%-80%) of the asset purchase cost from long-term institutional lenders, securing the loan with a mortgage on the asset and assigning lease rentals directly to the lenders.
3. **Cross-Border Lease:** Leasing arrangement where the lessor and lessee are domiciled in different sovereign legal jurisdictions, leveraging tax arbitrage and international credit terms.

1.3 Strategic Advantages and Disadvantages of Lease Financing

Advantages:

- **To Lessee:**
    - Off-Balance Sheet Financing (under historical accounting standards; modern IFRS 16 / Ind AS 116 requires bringing finance leases onto balance sheets).
    - Preserves working capital by offering up to 100% asset funding without requiring upfront down payments.
    - Lease rental payments are fully tax-deductible operational business expenses.
    - Mitigates asset obsolescence risks under operating lease arrangements.
- **To Lessor:**
    - Generates consistent, predictable cash flow returns via periodic rental receivables.

- Retains ownership tax benefits, including claiming asset **depreciation tax shields**.

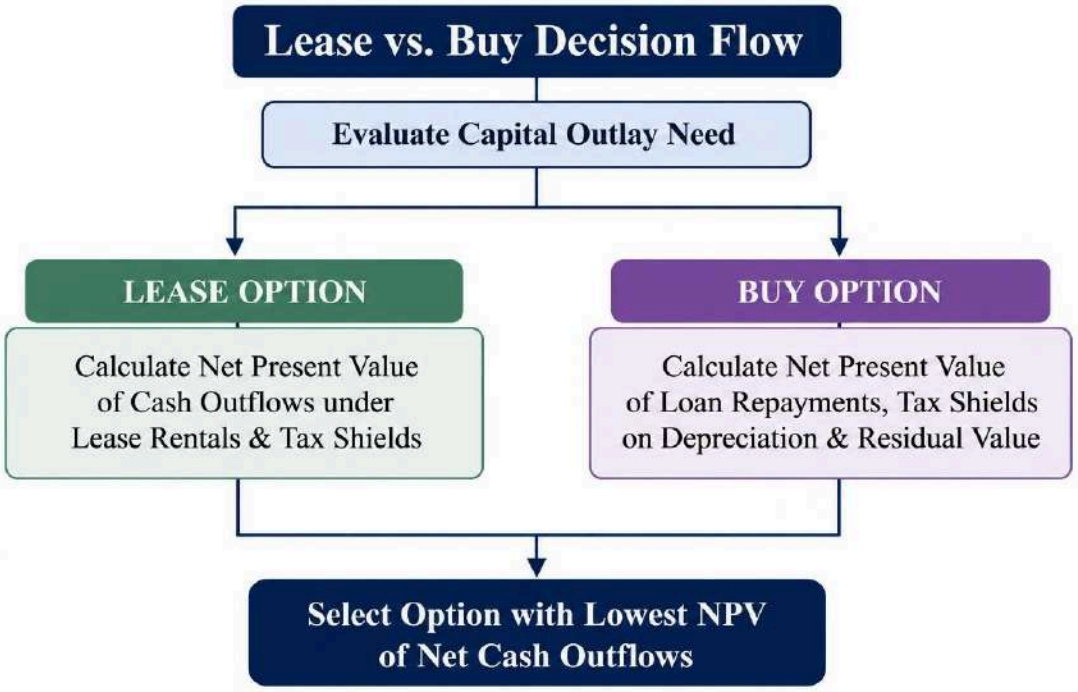
Disadvantages:

- Financial leases are binding and non-cancellable, locking lessees into long-term fixed liabilities even during business downturns.
- Net interest cost of leasing often exceeds traditional long-term debt or commercial mortgage rates.
- Lessee acquires no residual asset ownership equity upon lease contract termination unless explicit purchase options exist.

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2. FINANCIAL EVALUATION OF A LEASE DECISION

Corporate management must evaluate whether to **Lease an asset** or **Borrow funds to Buy the asset outright (Lease vs. Buy Decision)**.



2.1 Present Value (PV) Method

This method evaluates the net cash outflows associated with leasing against purchasing by discounting post-tax cash flows using the firm's after-tax cost of debt [${K}_{d}=r\times (1-t)$].

NPV of Leasing = Σ [L□ × (1 – t) / (1 + Kd)ᵗ], where t = 1 to n.

Where:

- L_t = Annual Lease Rental Payment
- t = Corporate Tax Rate
- K_d = After-Tax Cost of Debt Capital
- n = Lease Duration in Years

If the Present Value of Cash Outflows under the **Lease Option** is lower than the Present Value of Cash Outflows under the **Borrow-and-Buy Option**, leasing is the preferred capital option.

2.2 Cost of Capital Method

Computes the implicit internal discount rate (Internal Rate of Return - IRR) built into the lease rental stream and compares this cost directly against alternative sources of capital (debt, term loans, equity). If the implicit lease discount rate is lower than the weighted cost of alternative funding, the firm chooses the lease financing route.

2.3 Bower-Herringer-Williamson (BHW) Model

The BHW model decomposes the leasing decision into two separate financial elements:

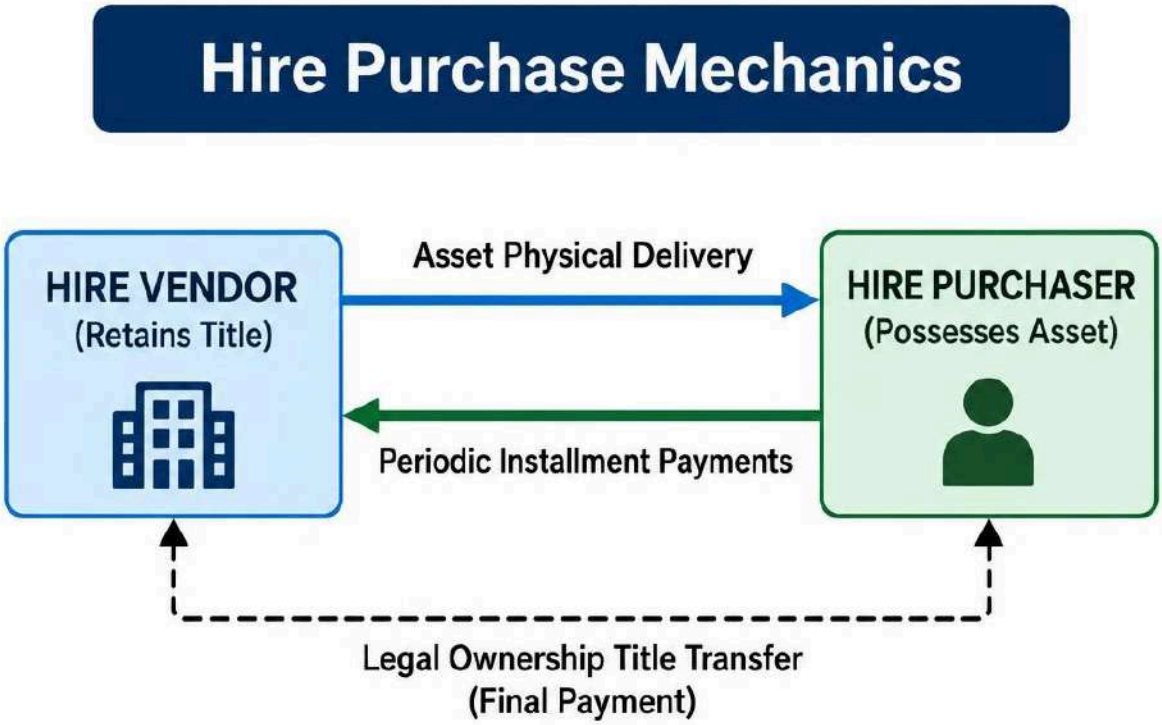
1. **Financial Advantage/Disadvantage:** Compares the present value of loan repayments against the present value of gross lease rentals discounted at the gross cost of debt.
2. **Operating Advantage/Disadvantage:** Measures the differential tax benefit derived from lease rental tax deductions versus tax deductions obtained through asset depreciation and loan interest shields.

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3. HIRE PURCHASE, CONSUMER CREDIT, CREDIT CARDS, AND DEBIT CARDS

3.1 Hire Purchase Framework

Hire purchase is a legal transaction structure where an asset is delivered to a buyer (**Hire Purchaser**) who pays for it in periodic installments. Asset ownership legally remains with the seller (**Hire Vendor**) until the final installment plus interest is paid, at which point legal title transfers to the purchaser.



Key Differences Between Lease Financing and Hire Purchase:

Analytical Feature	**Lease Financing**	**Hire Purchase**
Ownership Transfer	Title stays with Lessor; rarely transfers to Lessee.	Title automatically transfers upon final installment payment.
Asset Depreciation	Claimed by Lessor (legal owner of asset).	Claimed by Hire Purchaser (asset user).
Maintenance Obligations	Borne by Lessor (Operating) or Lessee (Finance).	Borne entirely by Hire Purchaser.

Analytical Feature	Lease Financing	Hire Purchase
Balance Sheet Impact	Assets historically capitalized under modern Ind AS.	Capitalized on Hire Purchaser's balance sheet from inception.
Tax Treatment	Entire lease rental is tax-deductible expense.	Only interest component of installment is tax-deductible.

3.2 Consumer Credit Mechanisms

Consumer credit represents short- to medium-term unsecured or secured credit extended to retail consumers to fund immediate purchases of consumer durables (automobiles, electronics, appliances, housing renovations).

- **Unsecured Consumer Credit:** Personal term loans, revolving credit, store cards based on credit scoring.
- **Secured Consumer Credit:** Auto loans, collateralized consumer electronics finance, asset-backed personal credit.

3.3 Credit Card Services

A credit card is a payment instrument issued by financial institutions granting the cardholder a revolving unsecured line of credit up to a pre-approved credit limit, allowing purchases and cash advances on a deferred settlement basis.

Core Features and Financial Mechanisms:

- **Interest-Free Grace Period:** Cardholders receive an interest-free window (typically 20 to 50 days) on fresh retail transactions, provided the previous statement balance was cleared in full by the due date.
- **Revolving Credit & Minimum Due:** Allows cardholders to pay a minimum portion (usually 5%) of the total bill balance while rolling over the remaining balance to the next billing cycle, incurring annualized finance interest charges (ranging from 36% to 48% per annum).
- **Interchange and Revenue Model:** Card issuers earn income through annual card fees, finance interest charges, late payment penalties, cash advance charges, and **Merchant Discount Rates (MDR)** charged on merchant transaction values.

3.4 Debit Card Services

A debit card is a payment card linked directly to a cardholder's demand deposit bank account (checking or savings account). Executing a transaction instantly debits funds directly from the cardholder's available bank balance.

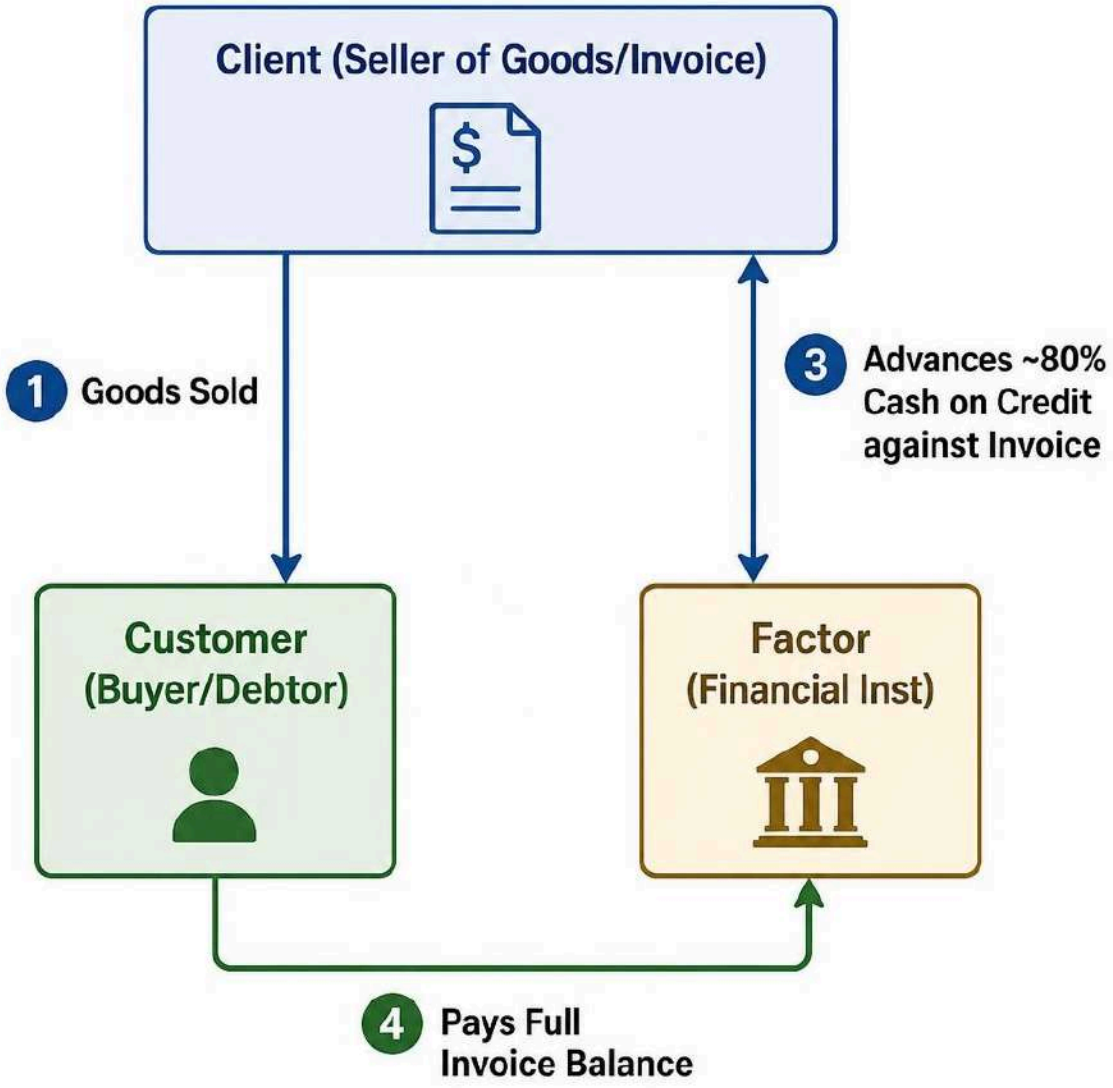
- **Key Operational Attributes:**
    - Functions as an electronic substitute for cash transactions and check writing.
    - Doubles as an Automated Teller Machine (ATM) card for instant cash withdrawals.
    - Carries zero interest expense liabilities or credit debt trap risks since spending is capped by available deposit balances.

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4. SHORT AND MEDIUM-TERM ASSET FINANCING: FACTORING, BILL DISCOUNTING, FORFAITING, REVERSE MORTGAGE, AND BNPL

4.1 Factoring Services

Factoring is a financial arrangement where a commercial enterprise (**Client**) sells its trade accounts receivable (invoices) at a discount to a specialized financial institution (**Factor**) to obtain immediate cash liquidity and outsource sales ledger management.



A. Operational Steps in Factoring:

1. Client sells goods to Customer on credit and issues a invoice.
2. Client assigns and transfers the invoice to the Factor.
3. Factor immediately disburses an upfront cash advance (typically **80% to 90%** of invoice value) to the Client.
4. Factor manages receivables collections from the Customer. Upon full collection, the Factor remits the remaining balance to the Client, minus a factoring commission and interest fee.

B. Typology of Factoring Arrangements:

- **Recourse Factoring:** The Client retains the ultimate credit risk. If the buyer defaults or fails to pay the invoice, the Factor recovers the advanced funds directly from the Client.
- **Non-Recourse Factoring:** The Factor assumes full credit default risk. If the buyer defaults due to financial insolvency, the Factor absorbs the financial loss without recourse to the Client.
- **Full-Service Factoring:** The Factor provides accounts receivable collection, sales ledger maintenance, credit analysis, and non-recourse credit protection.
- **Domestic vs. Export Factoring:** Covers domestic trade credit or international trade transactions involving foreign buyers and multi-currency factors.

4.2 Bill Discounting

Bill Discounting is a credit facility where a business entity sells its un-matured Bills of Exchange or promissory notes to a commercial bank or NBFC at a price lower than face value (discount rate), receiving immediate cash liquidity before the bill maturity date.

Key Differences Between Factoring and Bill Discounting:

Parameter	Factoring	Bill Discounting
Governing Framework	Governed by Factoring Regulation Act, 2011.	Governed by Negotiable Instruments Act, 1881.
Sales Ledger Management	Factor handles sales ledger accounting and collections.	Seller manages sales accounting and customer collection.
Notice to Customer	Customer is notified to pay the Factor directly.	Customer is generally not notified (Confidential arrangement).
Underlying Document	Based on trade receivables assignment/invoices.	Based on drawn Bills of Exchange / Trade Drafts.

4.3 Forfaiting Services

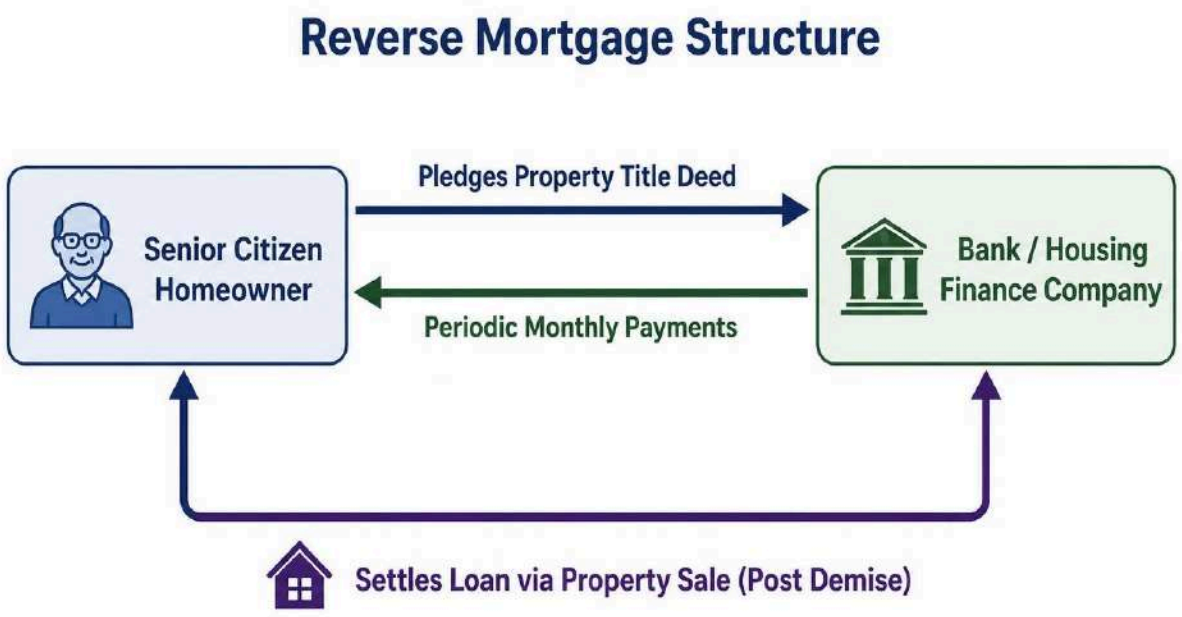
Forfaiting is a specialized international trade finance mechanism where an exporter sells its medium- to long-term trade receivables (guaranteed by an importing bank via a Letter of

Credit or Bill of Exchange) to a specialized financial institution (**Forfaiter**) on a **100% Non-Recourse basis**.

- **Key Features of Forfaiting:**
  - Used primarily for capital goods export transactions with credit terms ranging from **6 months up to 7 years**.
  - Always executed on a **Non-Recourse** basis, shifting all foreign commercial, political, and transfer risks away from the exporter to the Forfaiter.
  - Receivables are represented by negotiable financial instruments like Promissory Notes or Bills of Exchange, typically bearing an *Avavalization* (guarantee) from an international bank.

4.4 Reverse Mortgage

A Reverse Mortgage is a specialized financial product designed for senior citizens (typically individuals aged **60 years or older** in India) who own self-acquired residential real estate. Homeowners convert a portion of their home equity into regular tax-free monthly income streams or lump-sum payments without having to sell the property or vacate their residence.



Repayment Mechanism: The homeowner makes zero monthly loan interest or principal repayments during their lifetime. The loan balance (principal plus accumulated compound

interest) becomes due and payable only when the last surviving homeowner dies, permanently vacates the residence, or sells the property.

- **Settlement:** Heirs can clear the loan balance to retain the residence. Alternatively, the lender sells the property, recovers the outstanding loan debt, and remits any remaining capital surplus to the legal heirs.

4.5 Buy Now, Pay Later (BNPL)

BNPL is a digital short-term point-of-sale (POS) financing mechanism offered by fintech platforms that enables retail consumers to make immediate online or offline purchases and settle the invoice amount over a short duration (typically 14 days up to 3–6 months) through interest-free installments.

- **Tripartite Ecosystem:**
    1. **Consumer:** Enjoys instant point-of-sale credit access without requiring traditional credit cards.
    2. **Merchant:** Integrates BNPL checkout APIs, incurring a processing fee (2% to 8%) to drive higher order conversions and lower shopping cart abandonment.
    3. **Fintech Provider / NBFC Partner:** Assumes credit underwriting, customer acquisition, funding, and default collection risks.

UNIT – IV: MUTUAL FUNDS, VENTURE CAPITAL, CREDIT RATING, PORTFOLIO MANAGEMENT, AND WEALTH MANAGEMENT

1. MUTUAL FUND ORGANIZATIONS

1.1 Concept and Definition of Mutual Funds

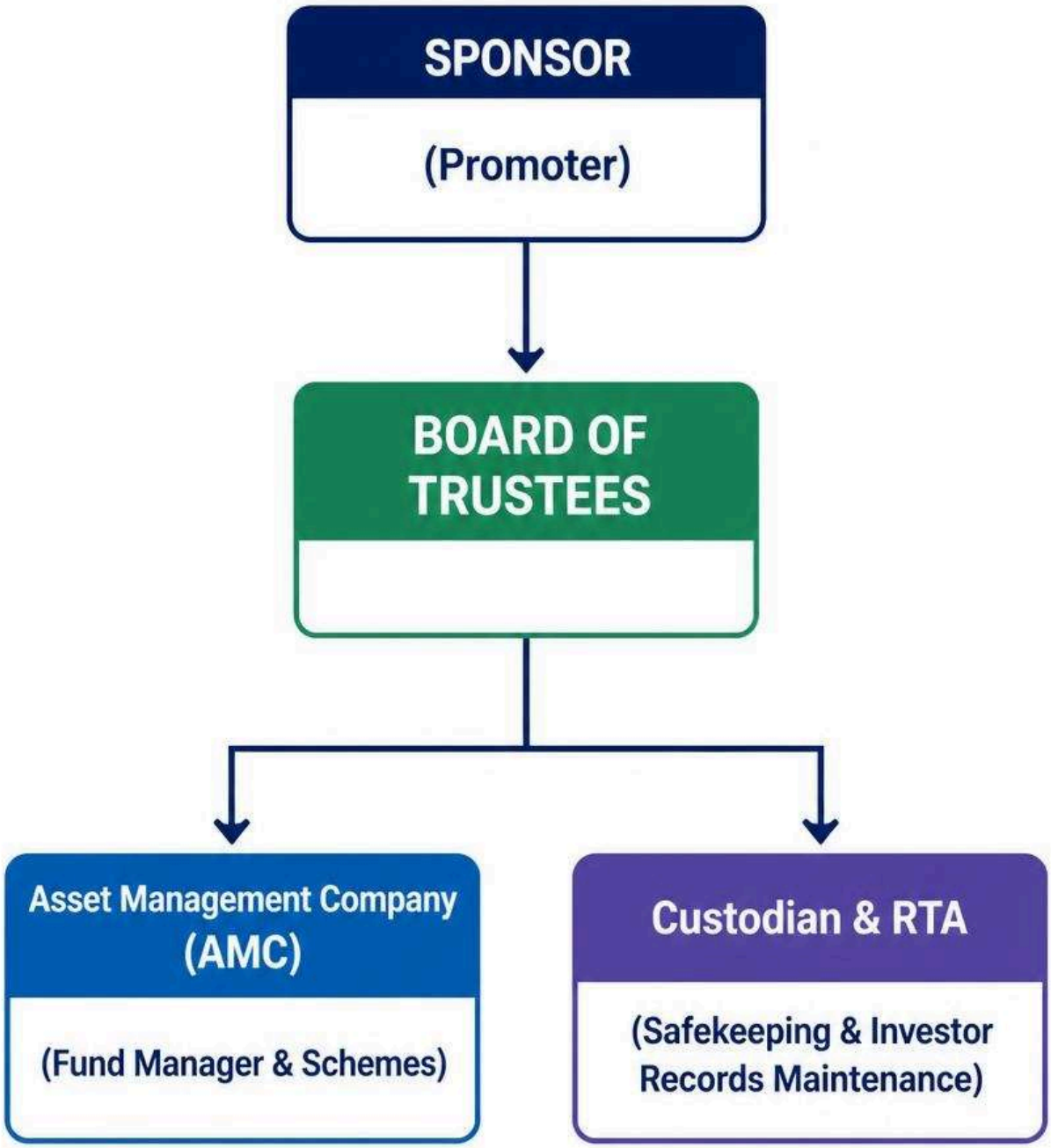
A mutual fund is a professionally managed financial intermediary that pools capital from numerous retail and institutional investors sharing common financial objectives, investing the aggregated corpus into a diversified portfolio of equity shares, fixed-income debt instruments, money market securities, or gold under SEBI regulations.



1.2 Structural Architecture of Mutual Funds in India

Under the **SEBI (Mutual Funds) Regulations, 1996**, mutual funds are structured legally as **Three-Tier Trust Structures**:

Mutual Fund Structural Architecture



Sponsor: The promoter entity (e.g., bank, corporate body) that establishes the mutual fund trust and registers it with SEBI, satisfying capital eligibility criteria.

2. **Board of Trustees / Trust Company:** Independent body holding fiduciary responsibility to safeguard unit holders' interests, ensuring the Asset Management Company operates within SEBI guidelines and statutory trust deeds.
3. **Asset Management Company (AMC):** The operational face of the mutual fund, appointed by Trustees to design schemes, market products, deploy investment strategies, manage portfolio assets, and compute daily **Net Asset Value (NAV)**.
4. **Custodian:** Independent SEBI-registered entity (e.g., Stock Holding Corporation, global banks) holding physical and dematerialized custody of portfolio securities, handling trade clearing settlements separately from the AMC.
5. **Registrar and Transfer Agent (RTA):** External service provider (e.g., CAMS, KFintech) managing unit holder accounts, transaction applications, allotment processing, dividend distribution, and account statements.

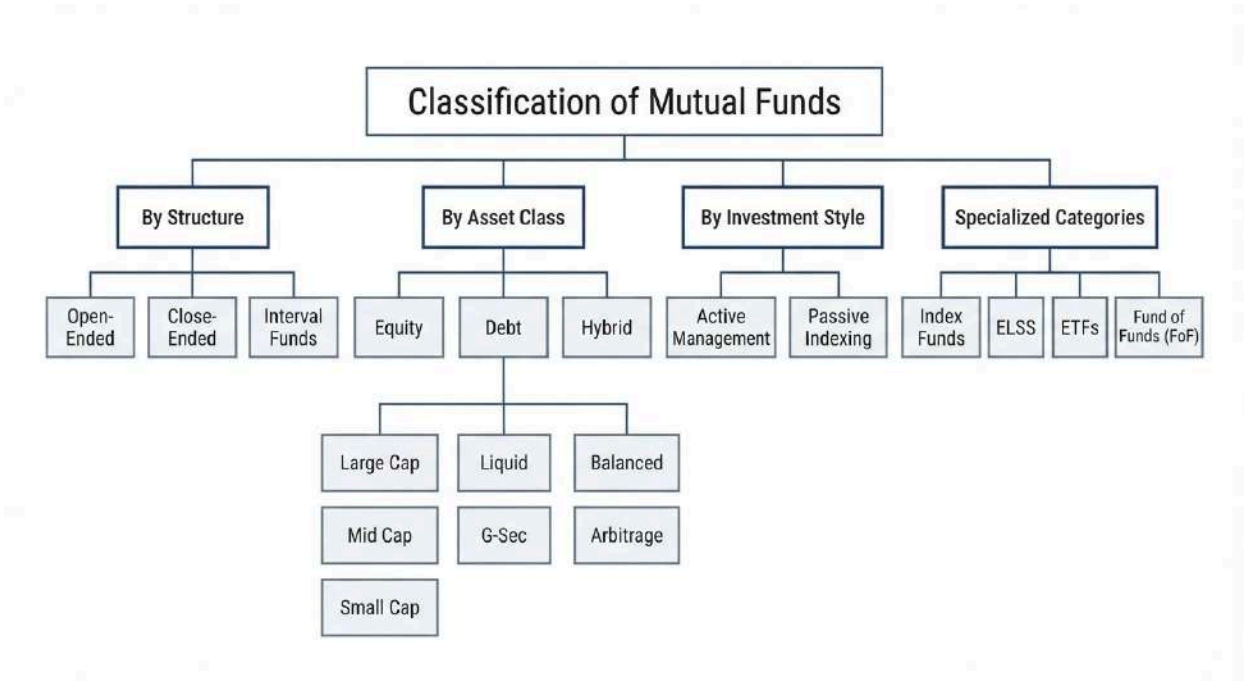
1.3 Net Asset Value (NAV) Calculation

Net Asset Value represents the market value of a single unit of a mutual fund scheme on a given evaluation day. It is calculated daily at market close using the formula:

NAV = (Total Market Value of Portfolio Assets + Receivables/Accrued Income – Total Liabilities/Accrued Expenses) ÷ Total Number of Outstanding Scheme Units

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1.4 Typology of Mutual Fund Schemes



A. Classification Based on Structure

- **Open-Ended Schemes:** Schemes available for continuous subscription and redemption at daily NAV-related prices. They have no fixed maturity period or unit cap.
- **Close-Ended Schemes:** Schemes with a fixed maturity period (e.g., 3 to 5 years). Units are offered via an initial New Fund Offer (NFO) and subsequently listed on stock exchanges for secondary trading.
- **Interval Schemes:** Hybrid models combining open-ended and close-ended features, permitting subscription and redemption at specific, predefined temporal intervals.

B. Classification Based on Asset Class

- **Equity Mutual Funds:** Invest predominantly (minimum 65% in India) in corporate equity shares, focusing on long-term capital appreciation. Sub-categories include Large-Cap, Mid-Cap, Small-Cap, Multi-Cap, Flexi-Cap, and Sectoral/Thematic Funds.
- **Debt Mutual Funds:** Invest in fixed-income securities like government bonds, corporate debentures, commercial paper, and Treasury bills, targeting income generation and capital preservation. Variants include Liquid Funds, Money Market Funds, Corporate Bond Funds, and Gilt Funds.
- **Hybrid Funds:** Invest in a combination of equity and debt assets to balance growth and capital stability (e.g., Aggressive Hybrid, Conservative Hybrid, Arbitrage Funds).

C. Specialized Mutual Fund Categories

- **Equity Linked Savings Scheme (ELSS):** Equity funds carrying a mandatory **3-year lock-in period**, offering tax deductions under Section 80C of the Indian Income Tax Act.
- **Exchange-Traded Funds (ETFs):** Passive investment funds tracking benchmark indices (e.g., NIFTY 50, Gold), listed and traded live on stock exchanges throughout market hours.
- **Index Funds:** Passive mutual funds holding securities in the exact proportion as a target index (e.g., NIFTY, SENSEX), minimizing portfolio turnover and expense ratios.

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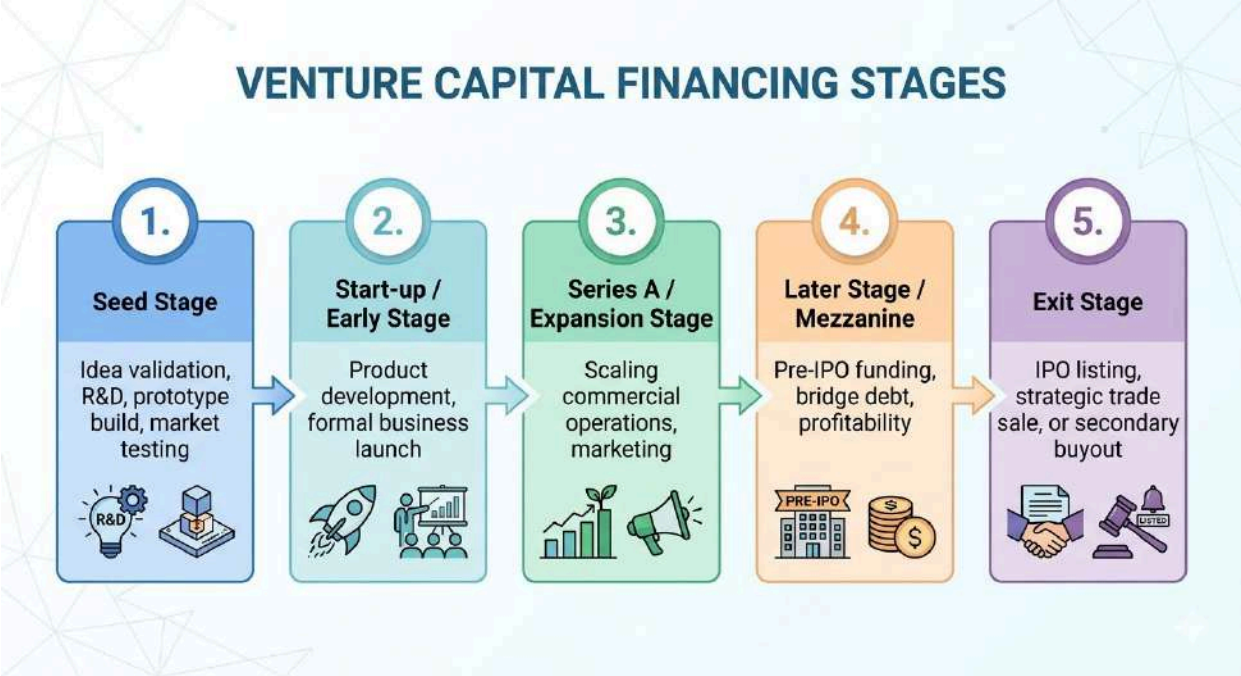
2. VENTURE CAPITAL FINANCING

2.1 Meaning and Features of Venture Capital

Venture Capital (VC) is a form of private equity financing provided by specialized investment firms to early-stage, high-risk, unlisted startup enterprises demonstrating substantial growth potential, disruptive business models, or technological innovation.

- **Key Operational Characteristics:**
    - **High Risk / High Return:** Early-stage investments face elevated failure rates offset by potential outsized capital gains.
    - **Equity Participation:** Capital is provided in exchange for equity ownership stakes or convertible equity instruments rather than interest-bearing debt.
    - **Long-Term Investment Horizon:** VC commitments require patient capital deployment over typical horizons of **5 to 10 years**.
    - **Hands-on Management Support ("Smart Money"):** VC investors provide strategic guidance, corporate governance oversight, recruitment support, and industry networking alongside financial funding.

2.2 Stages of Venture Capital Investment



2.3 Financial Instruments Used in Venture Financing

1. **Convertible Debt (Convertible Debentures):** Short-term debt notes that automatically convert into equity shares upon future funding rounds (e.g., Series A) at a predetermined conversion valuation or discount.
2. **SAFE Notes (Simple Agreement for Future Equity):** Pioneered by startup accelerators; non-debt convertible instruments granting investors rights to equity during future priced rounds without accruing interest or imposing fixed maturity dates.
3. **Preferred Equity:** Shares offering preferential dividend distribution and **Liquidation Preference** (ensuring VC investors recoup capital ahead of common equity holders during liquidations or fire-sales) alongside anti-dilution protections.

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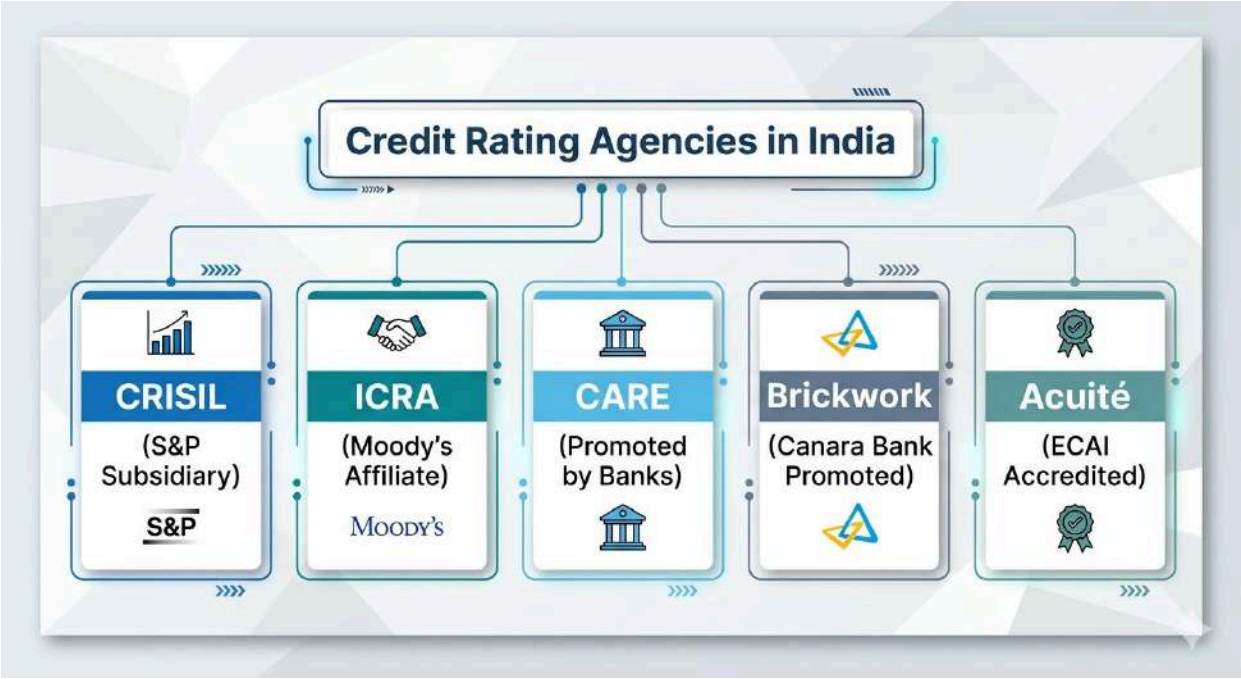
3. CREDIT RATING SERVICES

3.1 Meaning and Purpose of Credit Rating

Credit rating is a standardized, independent evaluation of the creditworthiness and default risk of a debt-issuing entity (corporation, sovereign state, financial institution) or specific financial obligation (bonds, debentures, commercial paper).

Credit rating agencies express their forward-looking opinions using standardized alphanumeric symbols (e.g., AAA, AA, BBB, C, D). A credit rating does not constitute a recommendation to purchase, hold, or sell a security.

3.2 Major Credit Rating Agencies in India



CRISIL (Credit Rating Information Services of India Limited): India's first credit rating agency, established in 1987; majority-owned by S&P Global.

1. **ICRA Limited:** Established in 1991 as Investment Information and Credit Rating Agency; strategic alliance with Moody's Investors Service.
2. **CARE Ratings (Credit Analysis and Research Limited):** Promoted in 1993 by major industrial financial institutions and commercial banks.
3. **Other Recognized Agencies:** Brickwork Ratings, Acuité Ratings & Research, Infomerics Valuation and Rating.

3.3 Standardized Rating Scale Architecture



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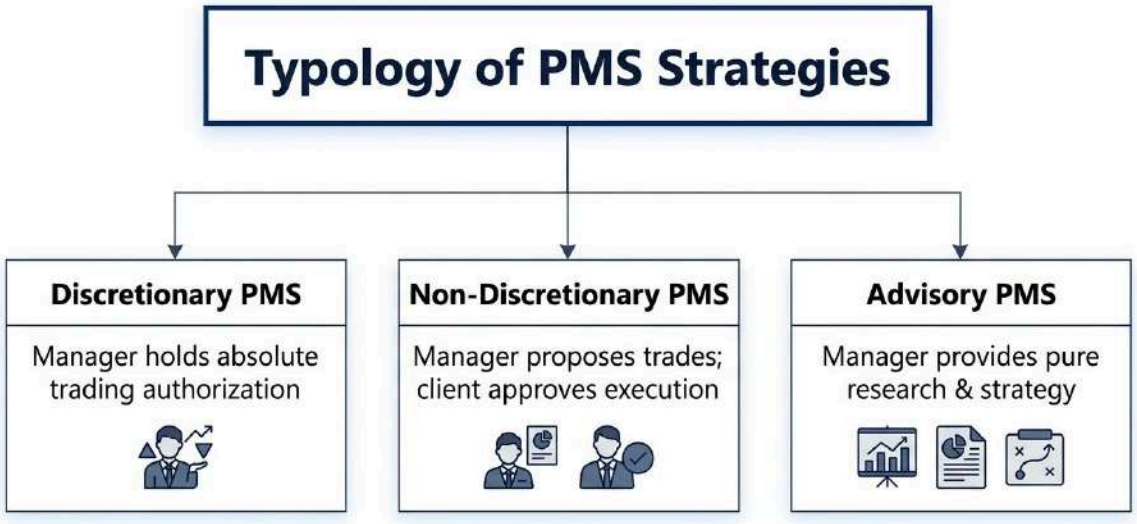
4. PORTFOLIO MANAGEMENT SERVICES (PMS)

4.1 Concept of Portfolio Management Services

Portfolio Management Services (PMS) represents a specialized investment management service offered by licensed professional portfolio managers to High-Net-Worth Individuals (HNWIs) and institutional clients. PMS tailors investment portfolios (comprising equity, debt, structured products, cash) to match client-specific risk profiles and return expectations.

Under **SEBI (Portfolio Managers) Regulations, 2020**, the minimum portfolio investment threshold for a PMS client in India is **₹50 Lakhs**.

4.2 Types of Portfolio Management Services



Discretionary PMS: The portfolio manager exercises absolute authority to execute investment decisions, asset allocations, and portfolio rebalancing on behalf of the client without seeking prior trade approval.

1. **Non-Discretionary PMS:** The portfolio manager provides investment analysis and trade recommendations, but trade execution requires explicit, prior approval from the client.
2. **Advisory PMS:** The portfolio manager functions purely as an investment advisor, offering research guidance while trade execution rests entirely with the client.

4.3 The Portfolio Management Process

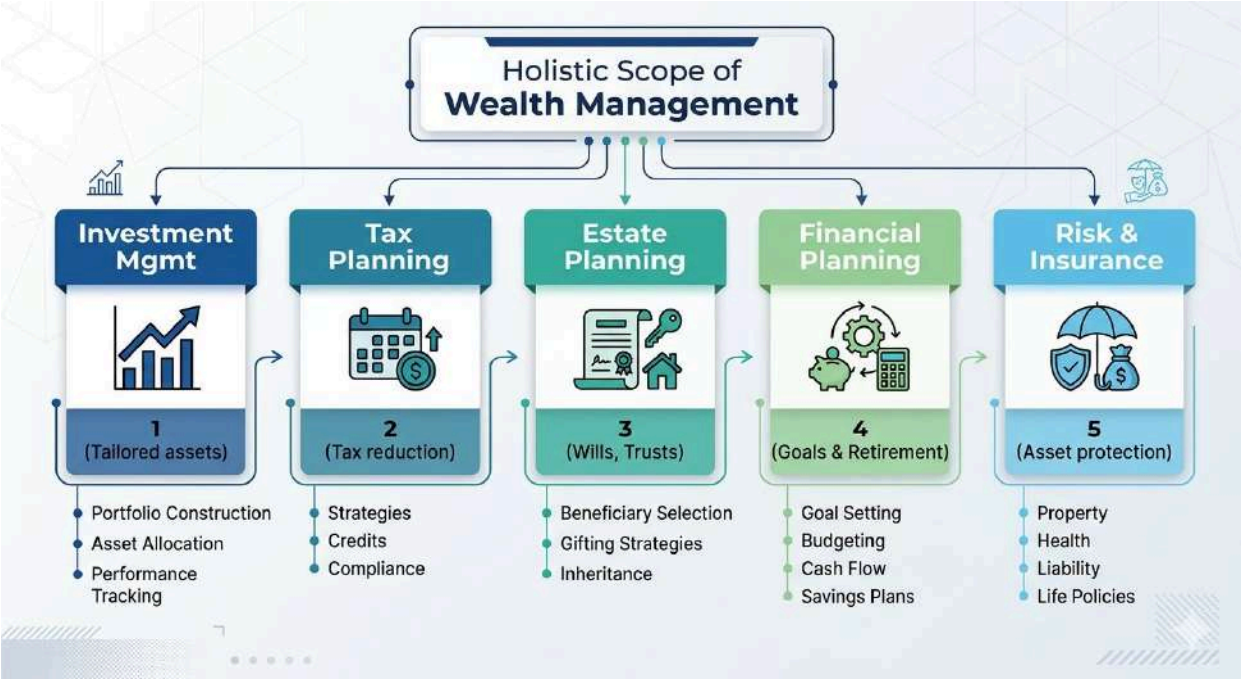
1. **Planning & IPS Construction:** Analyzing client return targets, liquidity needs, tax status, and risk tolerance to construct a tailored **Investment Policy Statement (IPS)**.
2. **Execution & Asset Allocation:** Allocating portfolio capital across asset classes (equities, debt, real estate, cash) based on strategic asset allocation framework.
3. **Feedback & Portfolio Rebalancing:** Continuously tracking portfolio performance against benchmark indices, executing rebalancing trades to realign risk profiles with the IPS.

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5. WEALTH MANAGEMENT SERVICES

5.1 Meaning and Holistic Scope of Wealth Management

Wealth management is an all-inclusive financial advisory service that combines financial planning, investment management, tax planning, estate planning, risk protection, and retirement strategies to manage the complete financial affairs of affluent clients and High-Net-Worth Individuals (HNWIs).



5.2 Core Components of Wealth Management Services

1. **Investment Advisory & Asset Allocation:** Designing customized, multi-asset portfolios aligned with short- and long-term financial goals.
2. **Tax Advisory & Optimization:** Formulating strategies to structure investments, business capital, and offshore structures to legally minimize tax liabilities.
3. **Estate Planning & Wealth Transfer:** Establishing Family Trusts, drafting legal Wills, and structuring succession frameworks to transfer wealth to heirs efficiently.
4. **Retirement & Cash Flow Planning:** Structuring annuities, passive income streams, and liquidity buffers to support client lifestyle requirements post-retirement.

UNIT – V: CONSUMER FINANCE, HOUSING FINANCE, SECURITIZATION, AND NBFC/MICROFINANCE MANAGEMENT

1. CONSUMER FINANCE AND HOUSING FINANCE

1.1 Concept and Significance of Consumer Finance

Consumer finance encompasses credit facilities extended to individual households to fund the purchase of consumer durables (automobiles, appliances, personal electronics, home furnishings) or meet immediate personal consumption expenditures.

Point-of-Sale (POS) Consumer Financing Models:

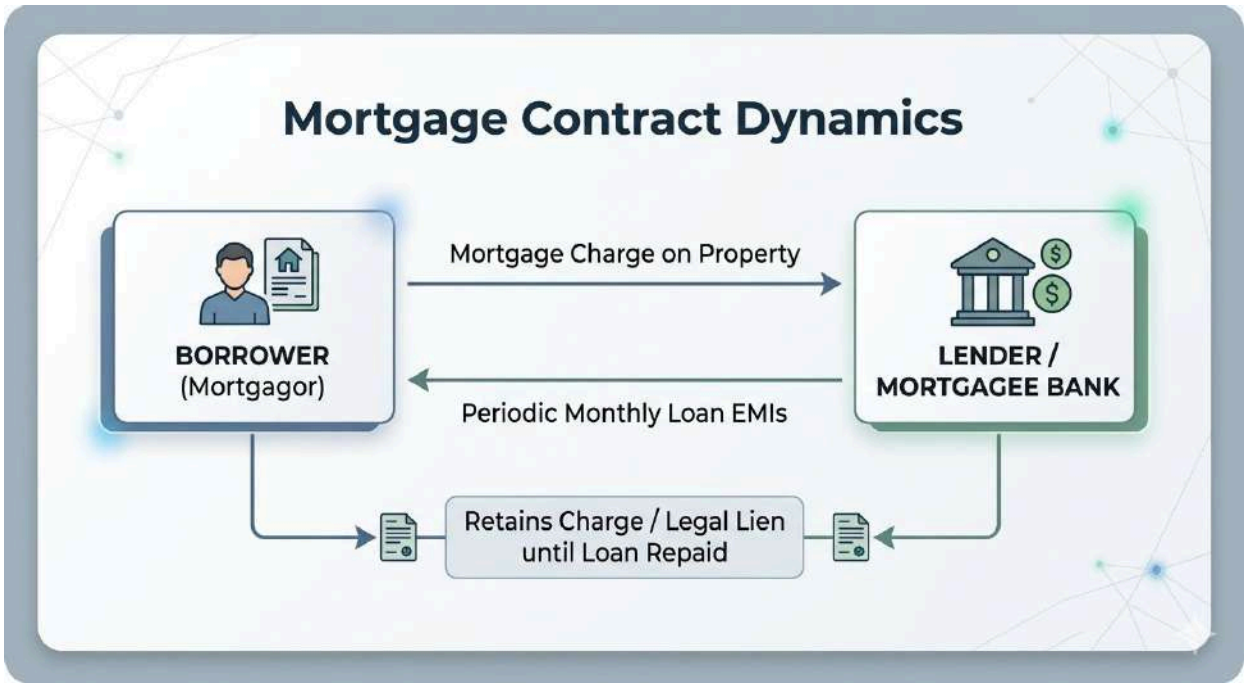
- **Store / Co-Branded Credit Cards:** Merchant-partnered credit cards providing targeted cash-back incentives and reward programs for specific store spending.
- **Consumer Durable Loans:** Asset-backed point-of-sale term credit structured through short-term Equated Monthly Installments (EMIs).
- **Buy Now, Pay Later (BNPL) Integration:** Embedded checkout APIs providing interest-free short-term installment facilities.

1.2 Housing Finance Framework

A. Meaning and Economic Scope

Housing finance refers to long-term mortgage credit extended to individuals, corporate entities, or housing cooperatives for acquiring, constructing, extending, or renovating residential units and real estate properties.

Housing finance drives macroeconomic growth by generating direct demand for steel, cement, electrical components, and construction labor, while driving financial deepening.



B. Regulatory and Institutional Structure in India

Housing finance institutions in India operate under the primary regulatory oversight of the **Reserve Bank of India (RBI)** (with the **National Housing Bank - NHB** acting as a specialized subsidiary dedicated to financing and housing market development).

C. Tax Incentives Supporting Housing Finance in India

To encourage residential home ownership, the **Indian Income Tax Act, 1961** provides significant tax deductions to home loan borrowers:

- **Section 24(b):** Deductions on interest paid on housing credit up to **₹2,000,000** per financial year for self-occupied residential property.
- **Section 80C:** Deductions on principal repayment amounts up to **₹150,000** per financial year within the overall Section 80C ceiling limit.

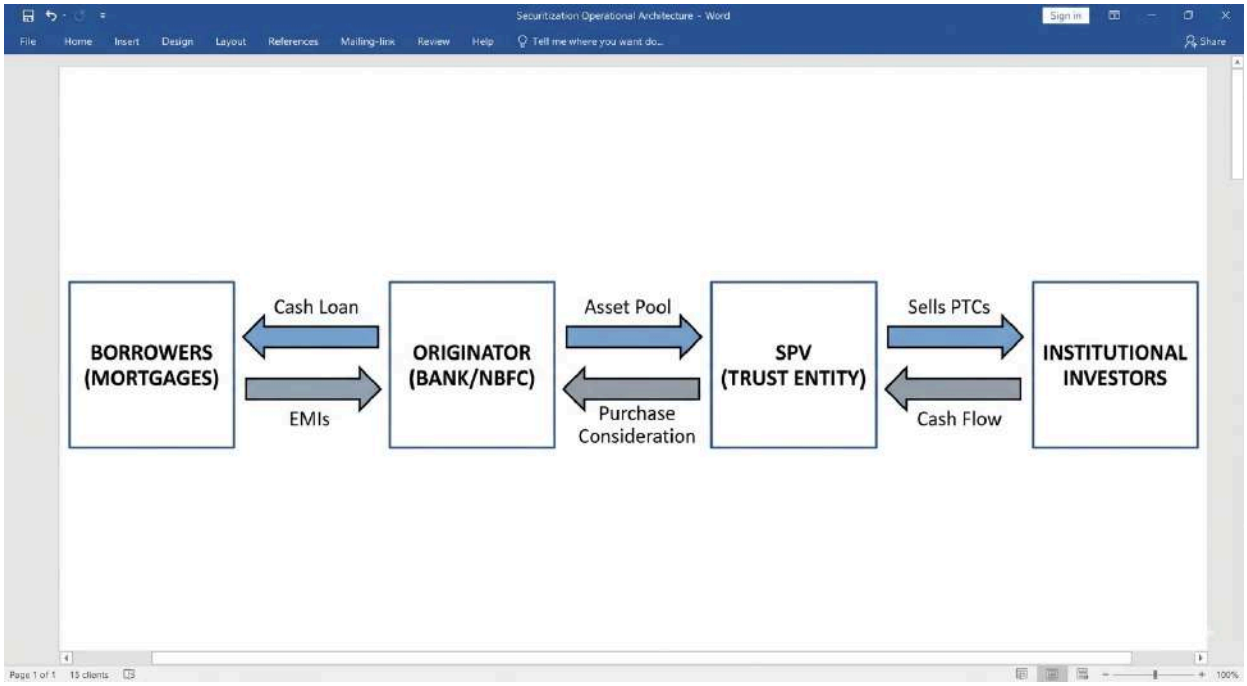
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2. SECURITIZATION IN INDIA

2.1 Meaning and Concept of Securitization

Securitization is a structured finance process where an original lending institution (**Originator**) pools together illiquid, income-generating credit assets (residential mortgages, auto loans, credit card receivables) and sells them to a **Special Purpose Vehicle (SPV)**.

The SPV converts these illiquid assets into tradable asset-backed security instruments (**Pass-Through Certificates - PTCs** or **Pay-Through Securities**) and sells them to capital market investors.



2.2 Core Parties Involved in Securitization

1. **Originator:** The financial entity (bank, NBFC, housing finance company) that originally extended loans to primary borrowers, creating the initial credit asset portfolio.
2. **Special Purpose Vehicle (SPV):** An independent bankruptcy-remote trust entity established to acquire the asset pool from the Originator, issue securitized instruments to investors, and isolate portfolio assets from the Originator's bankruptcy risks.
3. **Obligors:** The underlying borrowers whose loan repayments fund the cash flow supporting the securitized assets.
4. **Investors:** Institutional buyers (mutual funds, insurance companies, pension funds) purchasing securitized debt certificates.
5. **Credit Enhancement Provider:** Financial entity offering credit risk buffers (subordinated debt, cash collateral, bank guarantees) to elevate the credit rating of issued PTCs.
6. **Rating Agency:** Independent body evaluating and assigning credit ratings to the securitized instruments.

2.3 Major Asset Classes Amenable to Securitization

- **Mortgage-Backed Securities (MBS):** Securitized pools consisting of long-term residential or commercial property mortgages.
- **Asset-Backed Securities (ABS):** Securitized asset pools consisting of auto loans, commercial vehicle credit, consumer durable loans, or credit card receivables.
- **Infrastructure Receivables Securitization:** Future revenue streams generated from toll roads, power utility tariffs, and airport infrastructure projects.

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3. NON-BANKING FINANCIAL COMPANIES (NBFCs) AND MICROFINANCE

3.1 Meaning and Regulatory Profile of NBFCs

A Non-Banking Financial Company (NBFC) is a company registered under the Companies Act and regulated by the Reserve Bank of India under Chapter III-B of the **Reserve Bank of India Act, 1934**.

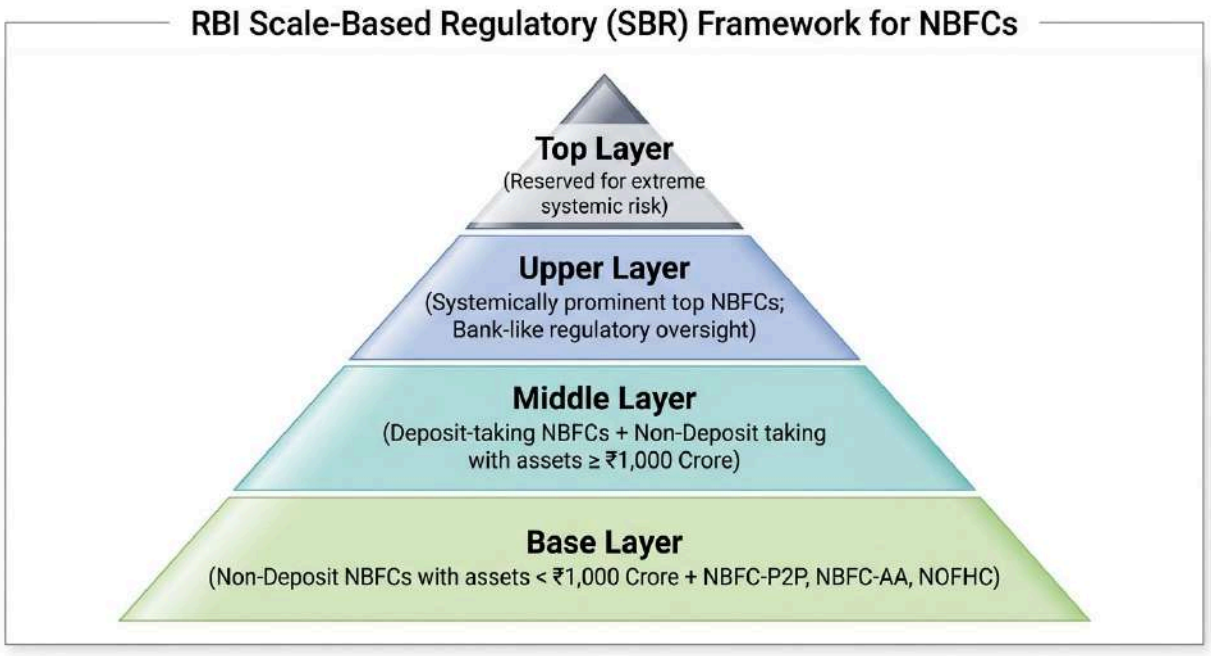
NBFCs provide financial services including term credit, equipment leasing, hire purchase financing, housing credit, asset management, and venture funding.

Basis of Difference	Commercial Banks	NBFCs
Demand Deposits	Can accept demand deposits through Savings and Current Accounts.	Cannot accept demand deposits through Savings and Current Accounts.
Payment and Settlement System	Form part of the Payment and Settlement System.	Do not form part of the Payment and Settlement System.
Cheque Facility	Can issue cheque books and cheques drawn on themselves.	Cannot issue cheques drawn on themselves.
Deposit Insurance	Deposits are covered by DICGC insurance up to ₹5 lakh per depositor, subject to applicable conditions.	NBFC deposits are not covered by DICGC deposit insurance.

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3.2 RBI Scale-Based Regulation (SBR) Framework for NBFCs

To protect financial stability, the RBI instituted a four-tiered **Scale-Based Regulatory (SBR)** structure calibrated to NBFC size, operational complexity, and systemic risk:



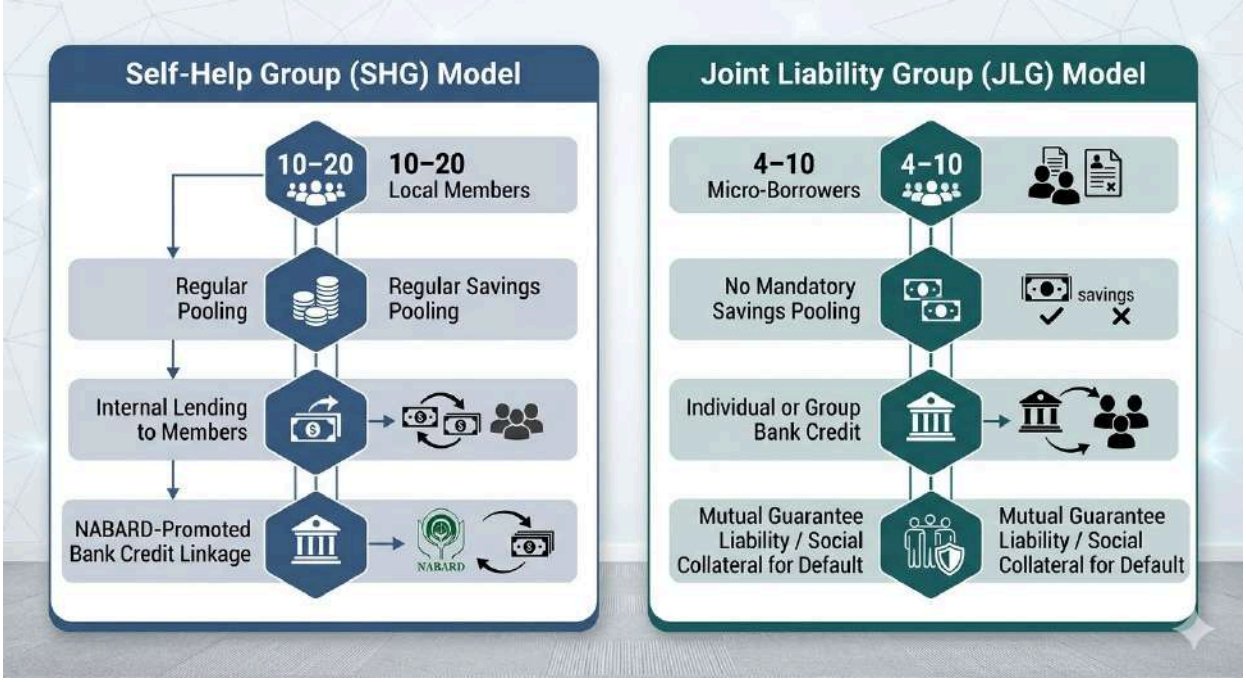
3.3 Microfinance Institutions (MFIs)

A. Meaning and Institutional Concept

Microfinance represents the provision of small-scale financial services—including microcredit, micro-insurance, micro-savings, and fund transfers—extended to low-income individuals, self-employed workers, micro-entrepreneurs, and marginalized groups lacking access to traditional banking channels.

B. Joint Liability Groups (JLGs) and Self-Help Groups (SHGs)

Because low-income micro-borrowers lack conventional physical collateral, microfinance institutions utilize social collateral models:



Self-Help Group (SHG) - Bank Linkage: Voluntary groups of 10–20 local micro-borrowers who pool small savings regularly and extend internal loans to members, leveraging bank credit linkages via programs promoted by NABARD.

- **Joint Liability Group (JLG):** Informal groups of 4 to 10 micro-borrowers who contractually accept **mutual guarantee liability**. If one individual group member defaults on an installment payment, the remaining group members are legally and socially responsible for settling the default amount.

C. Strategic Benefits and Socioeconomic Impact of Microfinance

1. **Poverty Alleviation:** Supplies productive micro-capital enabling impoverished households to launch micro-enterprises and generate sustainable income.
2. **Empowerment of Women:** Prioritizes female borrowers (comprising over 85% of MFI clients), enhancing household decision-making autonomy and living conditions.
3. **Eradication of Exploitative Moneylenders:** Replaces informal, predatory informal moneylenders charging usurious interest rates with structured microfinance lending rules.
4. **Promotion of Financial Literacy:** Combines credit distribution with basic business education, budgeting skills, and digital payment orientation.

3.4 Strategic Operational Challenges Facing Microfinance

- **Over-Indebtedness & Multiple Lending:** Micro-borrowers taking loans simultaneously from multiple MFIs, resulting in debt traps.
- **High Operational Costs:** Servicing small-ticket micro-loans across remote rural geographical regions raises transaction and collection overhead costs.
- **Credit Assessment Hurdles:** Absence of formal credit histories or structured accounting documentation for low-income populations.
- **Systemic Credit Default Risks:** Vulnerability of rural income streams to local agricultural droughts, floods, natural disasters, or local political interference encouraging credit defaults.