

Management of Commercial Banking
Professor. Jitendra Mahakud
Department of Humanities and Social Sciences
Indian Institute of Technology, Kharagpur
Lecture 56
Management of Off- Balance Sheet Activities 3

So, in continuation with the discussion on the Off-balance Sheet items of the commercial bank in the previous class, we discussed about certain instruments like your derivatives instruments. We have the loan commitments, note issuance facility and all kinds of thing. Today we can extend our discussion to some other off-balance sheet items. What always commercial banks use for their banking activity.

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CONCEPTS COVERED

- Loan Sales
- Trade Finance
- Foreign Exchange
- Services for Fee
- Investment Banking
- Selling Investment Product

So, those items include the loan sales, a trade finance. We have the foreign exchange business, what the commercial banks always do. Then we have the services, whatever the other services, the commercial banks provide and against that they charge some fee. Then we have the investment banking, which is also different from the commercial banking, but commercial banks also provide certain investment banking services at the time of requirements and they have also the selling the investment products.

So, these are the different other kind of services or other kind off-balance sheet items which exist with the commercial banks. We can see that how those kind of things are defined and how those

things really helpful for the banks to generate certain kind of revenue, which has the larger implications from the total profitability of the commercial bank.

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Other Off Balance Sheet Activities: Loan Sales

- Banks can sell loans to a third party as a source of funds
- Normally purchased by large banks and non-financial institutions
- Loan sales can be made with or without recourse
- Sales with recourse: even though the loan sold by assignment (i.e. buyer holds the loan), the selling bank retains some credit risk (in whole or in part) for loan losses
- Benefits of loan sales:
 - i. Enables bank to increase diversification
 - ii. Lower capital requirements
 - iii. Eliminate low earning assets from their portfolio
 - iv. Reduces credit risk

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So, here on whenever you talk about the loan sales, what it exactly means the bank can sell their loans to a third party as a source of the fund. Normally, what happened that this is mostly purchased by the large banks and the nonfinancial institutions, if a smaller bank has provided a larger loan, a big loan, then that loan can be sold to another bank and the particular bank can share the credit risk, what the small bank has already have.

So, in this context the larger banks can share the credit risk with a smaller bank and the smaller bank in that process is selling that loan to the larger bank. So, it is basically sharing the credit exposure between the different types of banks which are existing in the system. So, the loan sales is always made to get rid of the credit risk in the system and even though the loan sold by assignment, if the loan sold by assignment that is the buyer holds the loan, the selling bank retains some credit risk in whole or in part for loan losses.

Because it is shared between the two different parties. So, whoever has the initiator of that particular loan, they also share some credit risk and the particular bank who was bought that particular loan from this another commercial bank who was initiated that loan, they also share

some credit risk. Because now the loan is shared between the two different entities and the two different entities basically has always exposed to certain kind of loan losses.

So, if there is a probability of loan losses, then obviously, they are also exposed to some amount of credit risk in the system. But there are certain benefits, what we can receive whenever we provide this kind of or we involved in activities like the loan sales. What are of those type of benefits, what we can get, it enables the bank to increase the diversification. First of all the bank who is buying this particular loans they are able to diversify their loan business in the system or they have the kind of excess surplus they, whatever they have and that particular money also can be utilise in the market in a proper way.

It also helps in terms of lower capital requirements. Because the amount of money, which is required that basically is already materialized in the market. So, because of that, the capital requirements accordingly is changed and the commercial banks can enjoy that particular benefits from this and it eliminate the low earning assets from their portfolio. That is also another advantage we can get and the particular bank who was shared that particular loan. They are also able to reduce some amount of credit risk.

So, one major thing is, it is increasing the diversification that where then, they are able to minimize the risk and it is also helping to reduce the credit risk because the smaller banks may not be compatible or may not be well enough to bare that amount of credit risk in the market whenever they have given a larger loan to the customer. So, this is the way the loan sales work.

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The slide features a blue header with the title "Other Off Balance Sheet Activities: Loan Sales". The background is white with faint icons of gears, a lightbulb, and a network diagram. A small inset video of a man in a light green shirt is visible in the bottom right corner of the slide area. The text on the slide is as follows:

- Demerit: Banks could sell off high-quality, highly marketable loans and eventually end up with lower quality loans on balance sheet
- Implications of loan sales:
 1. Make loans without relying on deposits as a source of funds
 2. Convert traditional lending into quasi-securities business
 3. By purchasing loan sales, other non banking financial institutions are becoming more like banks

At the bottom of the slide, there is a black bar with the NPTEL logo on the left and the text "NPTEL Online Certification Course" in the center.

But there are some demerits the bank would sell off the high quality, high marketable loans and eventually end up with lower quality loans on the balance sheet. So, if the loan particular loan is doing well, but still because of certain reasons, the bank has gone for long selling, then the bank can incur certain kind of losses, if they will go for a low quality loans after that.

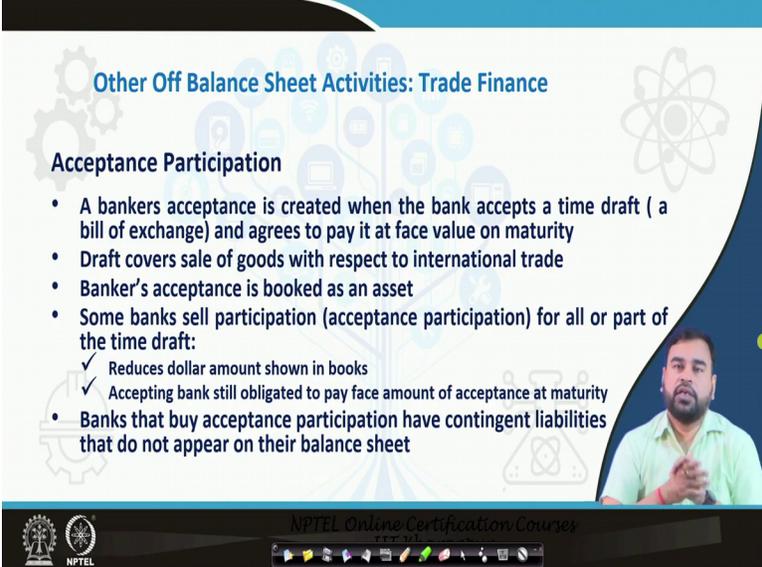
So, in that process to fulfil the requirement of the customer, they can go for the loan selling because they have, do not have enough cash available with them. But in that particular process, sometimes also they have chosen a certain kind of customer or the loan seeker who is basically not in that quality loan seeker or the probability of default against that particular loan seeker is relatively higher.

So, in that case they are exposed to more credit risk in comparison to the risk, whatever they have in the future. Whenever the larger loans was involved with respect to that bank. So, if you talk about the implications of the loan selling, there are many implications what we can get that make the loans relying on deposit at the source of the funds that means without deposits also the commercial bank can provide the loan in the process of the loan selling that is a number one.

It covert the traditional lending into quasi securities business, in terms of direct lending activities they can have the lending activities where the credit exposure is relatively less and as well as the credit risk of that particular bank also relatively less. By purchasing the loan sales other non-

banking financial institutions are becoming like banks or they provided certain kind of behaviour. What exactly the banks are providing whenever they are involved in kind of loan business. So, these are the different implications, what we can draw, whenever the loan selling take place by a commercial bank because of certain reasons.

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Other Off Balance Sheet Activities: Trade Finance

Acceptance Participation

- A banker's acceptance is created when the bank accepts a time draft (a bill of exchange) and agrees to pay it at face value on maturity
- Draft covers sale of goods with respect to international trade
- Banker's acceptance is booked as an asset
- Some banks sell participation (acceptance participation) for all or part of the time draft:
 - ✓ Reduces dollar amount shown in books
 - ✓ Accepting bank still obligated to pay face amount of acceptance at maturity
- Banks that buy acceptance participation have contingent liabilities that do not appear on their balance sheet

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Then another one is your acceptance, participation. There is also another instrument the bank use as an off-balance sheet items. So, a banker's acceptance is created, when the bank accepts a time draft, basically a bill of exchange and agrees to pay it at face value on the maturity.

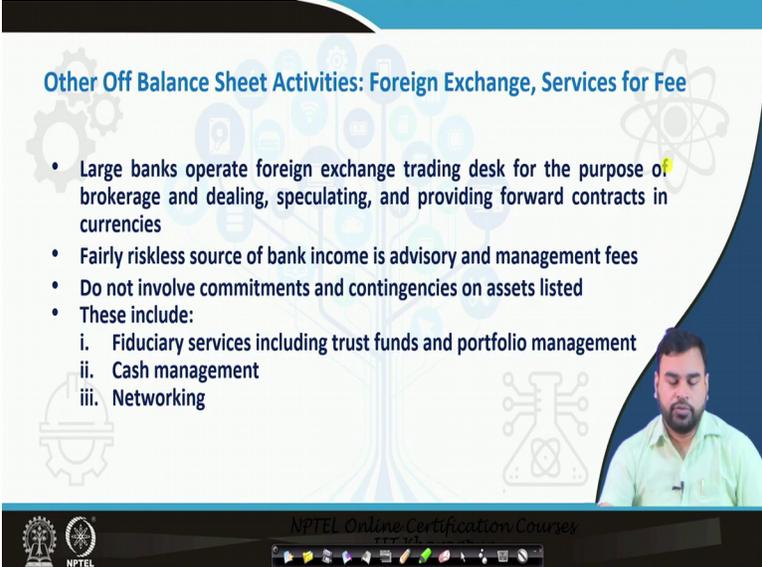
In the previous class, we were discussing about the letter of credit in that process also, if the more or less synonymous to that process that whenever we are using that particular instrument as a off-balance sheet item, the bank is basically accepts a draft, time draft which is nothing but a bill of exchange and they are agreed to pay at the face value at the maturity, if under certain terms and conditions and this particular draft basically covers the sale of goods with respect to the international trade and the banker's acceptance is booked as an asset.

It is considered, banker's acceptance can be considered as an asset by the entities who are basically dealing with this kind of business. Some banks can sell the participation certificate for all or part of the time draft whenever they are able to or they are selling this kind of participation certificate to the different other entity. Then they can reduce their dollar amount shown in the

books. Number one, it will have a tangible impact on the balance sheet of that particular commercial bank.

Then also they are accepting the banks still obliged to pay the face amount of acceptance at the maturity. So, this is what basically the characteristics and banks which buy this and acceptance participants have the contingent liabilities and that do not appear on their balance sheet. So, the acceptance certificate is also again a kind of contingent liabilities, what the banks have and therefore it is not basically shown or reflected in their balance sheet item, whatever way, in actual sense we prepared the balance sheets of the commercial bank.

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Other Off Balance Sheet Activities: Foreign Exchange, Services for Fee

- Large banks operate foreign exchange trading desk for the purpose of brokerage and dealing, speculating, and providing forward contracts in currencies
- Fairly riskless source of bank income is advisory and management fees
- Do not involve commitments and contingencies on assets listed
- These include:
 - i. Fiduciary services including trust funds and portfolio management
 - ii. Cash management
 - iii. Networking

The slide features a blue and white color scheme with decorative icons of gears, a lightbulb, and a molecular structure. A small video inset in the bottom right corner shows a man in a light green shirt speaking. The NPTEL logo is visible in the bottom left corner, and the text 'NPTEL Online Certification Courses' is at the bottom center.

So, the large banks operate the foreign exchange trading. Another services, the banks provided that is the foreign exchange mostly in India, if you observe that the foreign exchange transactions are done through the commercial banks only and we have the two segments. One is your wholesale segment, another one the retail segment.

For both the segments, the banks basically play a significant role. So, in that sense any kind of foreign exchange transaction which takes place that is under the control of the direct Central Bank, which is the Reserve Bank of India and the Reserve Bank of India, basically do this foreign exchange business through this commercial banks.

So, the Reserve Bank of India provides this kind of facility to the commercial banks to carry out that, according to the instructions the commercial banks carry out this foreign exchange business, in terms of the payment of the export financing, in terms of the payment of the different kind of other trading activities which is happening. So against that, this foreign exchange business plays a very significant role and this is one of the major businesses, what the commercial banks always operate.

So, fairly it is riskless source of bank income. Because the bank basically charges certain advisory or management fees whenever they do this foreign exchange business on behalf of a different type of customers and mostly the oil companies, in other companies who have the kind of joint venture in India with a collaboration with other companies. They basically take the help of the kind of foreign exchange transactions from the commercial bank and against that facility bank charges a certain kind of premium.

So, it basically those do not involve the commitments and contingencies and assets which are listed already in the balance sheet of the Commercial Bank. But it has the implications on the total profit or total income what they are basically generating.

So, those things include the fiduciary services other kind of services what they provide that is basically the trust funds and the portfolio management services, they provide services like cash management and then the networking. So, these are the different services they provide and against that also they generate certain revenue. But that is basically not reflected in the balance sheet every time. But the bank is well enough, is good enough to generate some amount of revenue out of this.

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Other Off Balance Sheet Activities: Services for Fee

Cash management

- Used to help business concerns collect remittances and use their bank balances effectively
- Lock boxes are important part of cash management system
- Post office boxes where customer's remittances are sent via mail and then collected by bankers who deposit them in a business concern's account
- Banks receive fees for collection and processing funds

The slide features a blue and white color scheme with various icons representing business and finance. A small video feed of a man in a light green shirt is visible in the bottom right corner of the slide area. The NPTEL logo is in the bottom left, and the text 'NPTEL Online Certification Course' is at the bottom center.

Coming back to the cash management what basically we have seen that this basically used to have the business concerns collect the remittances and use their bank balances effectively and lock boxes are important part of the cash management system and the post office boxes where customer remittances are sent via mail.

And then collected by the bankers who deposit them in business concern's account and bank basically receives a fees and for the collection and the processing the funds which comes under the cash management and whenever the bank provide the portfolio management services, mostly the bank will act as a fund manager on behalf of the different type of stakeholders or the investors who exist in the market.

So, against that they provide different kinds of services in terms of maximizing the return with a given amount of risk. What the customer basically want and on the basis of the customer's risk tolerance limit or the risk appetite, the particular commercial banks decide that whether what kind of portfolio management services should be given to them, whether the particular investor is aggressively wants to invest in the market or the investor is a passive investor who wants to generate certain kind of regular income from this.

So, looking at the different type of requirements from the customer side the banks basically goes for this kind of a portfolio management services to them and accordingly, they also provide the

cash management services to the different funds. So, this is also another important off-balance sheet item the bank has.

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Other Off Balance Sheet Activities: Services for Fee

Networking/ Strategic Alliance

- Refers to linkages among different companies to exploit comparative advantage in the production and delivery of product
- Symbiotic relationship seeks to increase customer convenience for both retail and bank
- Also use network to sell insurance, data processing, and other services

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Then you have the networking or the strategic alliance. It can, it refers to basically linkages among the different companies to exploit. The comparative advantage in the production and the delivery of the product. The symbiotic relationship seeks to increase the customer convenience for both retail and the bank side and it used a different network to sell the insurance product, the data processing and the other services what the commercial banks can provide.

So, all kinds of services what the bank provide against that the bank basically charges the fee and that fee basically is consider as a reasonably good amount of income generating sources for the commercial banks as a whole. So, this is basically another services.

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Other Off Balance Sheet Activities: Investment Banking

- Provide advice to businesses, governments, and other institutions interested in expansion to new markets, pursuing mergers and acquisitions and offer new debt and equity securities in the financial marketplace
- When economy is booming, investment banking can be among the most profitable financial services

Leading investment banks in the world today:

✓ Citigroup	✓ Goldman Sachs	✓ Nomura Securities
✓ JP Morgan Chase	✓ Credit Suisse	✓ Deutsche Bank
✓ Morgan Stanley	✓ UBS	✓ Raymond James

The slide features a background with a blue and white color scheme, including icons of gears, a network diagram, and a stylized atom. A small video inset of a man in a light green shirt is visible on the right side of the slide. At the bottom, there is a footer with the NPTEL logo and the text 'NPTEL Online Certification Course'.

But the, another thing is, we have the, another aspect of this banking, this investment banking, although it is different from the commercial banking because commercial banking has a deposit base and from the deposits, they provide the loans. But whenever you talk about the investment banking, the investment banking has no deposits.

So, if you see in India, we have very few specific investment bankers or investment banks which are existing. Who provides exclusively the investment banking services. But in Indian context, we have a kind of different kind of model what we adopt that our banks work like a commercial bank. They consider the deposits from the customer and provide the regular banking activities like providing loans, making the investments in SLR, giving the CRR requirements in all kinds of things.

But they also have investment banking division, which division basically plays a role whenever it comes to the investment banking services. What the commercial bank supposed to provide. So, whenever looking at the economic scenario, the business cycle and other conditions in the system, then what we can say that the commercial banks which provide this kind of investment banking services to the different customers, who are existing in this particular system. So, if you take some examples, there are many investment banks across the globe.

If you see we have Morgan Stanley, you have Goldman Sachs, you have Nomura, you have the Citigroup. So, those kind of services, those kind of banks are, do not provide the commercial banking services, but they are basically the investment bankers. But in India? We have a typical thing that we most of the commercial banks have investment banking division who provides all kind of investment banking services to their customers.

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The slide is titled "Other Off Balance Sheet Activities: Investment Banking". It features a background with a blue and white color scheme, including a gear icon on the left and a molecular structure icon on the right. A small inset video of a man in a green shirt is visible in the bottom right corner of the slide content. The slide lists the following key investment banking services:

- Traditionally, the best-known and often the most profitable investment banking service is security underwriting
 - Purchase for resale of new stocks, bonds, and other financial instruments in the money and capital markets on behalf of clients who need to raise new money
 - One of the most profitable underwriting services – initial public offerings (IPOs)
- Leveraged buyouts (LBOs): involve acquisition of a company, usually by a small group of investors, and typically are funded by large amounts of debt
- Recently, many investment banks jumped into the hedge fund business

At the bottom of the slide, there is a footer for "NPTEL Online Certification Courses" with the NPTEL logo on the left and a navigation bar on the right.

So, whenever talk about the investment banking services that includes the risk management that includes the pricing of the IPOs that includes the valuation of the mergers and acquisitions. There are many kind of functions what the investment bankers do and they also work as underwriter. They work as the broker or the lead manager in the IPO process and as well as they also provide certain kind of underwriting services at the time of the IPO issuance. So, many ways, the investment banking services and overall we can say that the risk management services is basically provided by the investment bankers.

So, whenever we get this risk management services from any kind of entity, mostly the entities are basically the investment banking division or investment bankers in the system. Traditionally, if you see that the best known or the most profitable investment banking services in security is the underwriting.

So, against that they charge basically high amount of money because under writing already you know that is a guarantee that with this particular process will have certain kind of issues then or the particular IPO process, this particular stock or particular IPO is not going to be subscribed, then it is the role of the underwriter who is bound to buy that particular asset and accordingly what we can say that they get certain revenue out of this in terms of the management fees. So, in the investment banking part, it was traditionally dominated by the underwriting services.

So, this basically involves the purchase of resale of the new stocks and bonds and other financial instruments in the money and the capital markets on behalf of the clients who basically need to raise new money into the system at that particular point of time. So, that is why the bank basically plays a very significant role in the context that the purchase for resell the new stocks, bonds and all kinds of financial assets. Whatever we have, those assets are basically considered whenever you go for designing this investment banking in a particular bank. For a particular bank.

Then the leveraged buyouts that also happens to risk investment banking concept. The leveraged buyouts is nothing but it involves the acquisition of a company usually by a small group of investors and typically they are funded by the large amount of debt whatever they have taken from a particular commercial bank.

By providing this kind of services to the other different entity, the bank basically is able to provide or bank can provide certain loans to a particular bank who is basically dealing with this kind of business and against that the bank will charge certain kind of revenue, certain kind of money for that.

Recently this many investment banks jumped into the hedge fund business. The hedge funds are different from the mutual fund, other funds which are existing in the system and how it is different that hedge funds are more risky and there is a, high net worth individuals can only participate or foreign institutional investors can participate in that particular process because the amount of transaction in that segment is quite high.

So, whenever you talk about the hedge funds, they are also. Sometimes, what happens that they can be the risk partner of that particular company on which this particular investments they are

making. So, there are many ways, basically the investment banking positions or investment banking services are given by the commercial bank and both if you talk about the investment banking services and commercial banking services in terms of taking deposits, paying the money as the loan. All kind of activities are basically done through the commercial banks, apart from the investment banking services, what they provide.

So, recently many investment banks jumped on the hedge fund that is true, because hedge fund is relatively risky. But the return also relatively quite high. So, the banks who have the expertise for managing the funds over a period of time, they can go for this investment banking services to generate some extra revenue.

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The slide features a blue header with the title "Other Off Balance Sheet Activities: Investment Banking". Below the title, it lists "Examples of client questions that investment bankers can assist in answering:" followed by four bullet points, each starting with a checkmark. The background includes faint icons of gears, a lightbulb, and a network diagram. A small video inset of a man in a green shirt is visible in the bottom right corner. The NPTEL logo and "NPTEL Online Certification Courses" are at the bottom.

Other Off Balance Sheet Activities: Investment Banking

Examples of client questions that investment bankers can assist in answering:

- ✓ Should the clients attempt to raise new capital? If so, how much, where, and how do we go about this fund-raising task?
- ✓ Should client's company enter new market areas at home or abroad? If so, how can we best accomplish this market-expansion strategy?
- ✓ Does client's company need to acquire or merge with other firms? Which firms and how? And when is the best time to do so?
- ✓ Should we sell our company to another firm? If so, what is our company worth? And how do we find the right buyer?

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Within this framework, what we have seen that investment bankers always assist in different ways. One is, they want to answer many questions to their clients. Should the clients attempt to raise new capital? If so, then how much, where and how we go about this fund raising task then whenever they can consult with that bank, who basically needs this kind of services from them.

Then whenever this particular consultation takes place, the bank basically always have certain kind of issues with respect to that and from the banking perspective and from the customer perspective, there is a two way conflict always may arise whenever this kind of situation will be prevailed in the market.

So, in this context, we can have three four questions which can be raised with respect this. The questions are like this. Should the client attempt to raise new capital? If so, how much? Where and how do we go about this fund raising task? In the sense that what basically we see that whenever the banks need new capital, they have to go for or the clients need to, new capital they have to go for any kind of issuance of the public money and the public money can be issued only through the initial public offerings, which is the process of the pricing of the IPOs or in short what we call it is the IPOs, the initial public offerings are mostly done by the commercial banks.

Only, because they have certain expertise with respect to that. Another question also they try to answer client, should client's company enter the new market area at home or the abroad? If so, then how can we best accomplish the market expansion strategy? The bank has always right to understand that where ever, how the particular company is operating and which are those places this particular operations are taking place accordingly, the bank can decide whether the particular type of loan should be given to them or not.

Then other one is the should we sell our company to another firm? If so, what is our company worth and how do we find the right buyers? All kinds of operations, all kind of activities are done by the investment bankers and against that they only provide the fees to the commercial banks. Other day-To-day operating activities they do not have to do. So, the basic notion of investment banking is borrow the money from the one source and provide that particular money for the different purposes to the different commercial banks which are existing in the system. So, this is the way the investment management activity works in the market.

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The slide features a blue header with the title "Other Off Balance Sheet Activities: Selling Investment Products". Below the title is a bulleted list of four points. The background is white with faint icons of gears, a tree, and a molecular structure. A small video inset of a man in a green shirt is visible in the bottom right corner. The NPTEL logo and "NPTEL Online Certification Course" text are at the bottom.

- Investment products like stocks, bonds, mutual funds, annuities and similar financial instruments seem to offer better returns than many conventional deposits
- Depositors also invested money in other alternate investment options like real estate in an effort to keep up with inflation
- In response banks developed investment and insurance products and offered financial planning services in an attempt to win back customers
- Most common investment product sold by depository institutions are Mutual Funds

Then we have in the today's context if you see now the America is also following this approach, what the India is following in terms of the banking services. After the failure of the Lehman Brothers and other kind of entities which are solving for a large number of period in the U.S market.

Which has been observed that because of certain kind of mismanagement or certain kind of unexpected calculation which were made, they have suffered a lot in that particular point of time, they do not have any kind of own capital base that own capital base is only the equity, but they do not have any kind of funds, what the commercial banks supposed to have in terms of the deposits.

But in a typical investment banker does not have that kind of deposit base and they have to generate the revenue by the different ways by investing the money in the market like your mutual funds, you have the stock market, you have the bond market, all kinds of options which are available in the system. So, they can use that particular thing to generate that particular revenue instead of relying upon only on the particular issue which talks about that how the commercial banks is able to maximize the profit by using those balance sheet data.

So, most common investment banking division. So, if you talk about most of the public sector banks or maybe the banks which have the largest share in the market, they provide this

investment banking services in India. Then we have another kind of activity off-balance sheet activity what the commercial banks do that is basically your selling these investment products. So, the investment products, like stocks, like bonds, mutual funds, annuities and the similar financial instruments seem to offer the better returns than the many conventional deposits, like fixed deposits or saving deposits and other things.

Depositors also invest their money in other alternative investment options like real estates. This is basically investment in the real estate is an effort to keep up with inflation. Because the valuation or the value of the real estate can increase on the basis of the demand forces in the market, demand in supply forces, obviously that will be there and as well as also the economic conditions or the price stability of the system as a whole. That also can play a role in that particular context.

That how this particular investment products is going to affect the balance sheet of the commercial banking system. In response to banks developed investment and insurance products and offered the financial planning services that also they provide in today's context and the most common investment product is basically the mutual funds. It is not only the mutual funds, the investment products also the banks provide like your insurance product and as well as the other products which are existing.

So, the mutual funds and other kind of products which are sold by the banks in for two ways. One is your to facilitate the customers and the as well as to generate some extra revenue in terms of their fee or may be services fee, what they charge against this particular thing.

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Other Off Balance Sheet Activities: Selling Investment Products

Mutual Funds

- Have been attractive to many individuals and institutional investors because long run yields appear to be relatively high and most funds are diversified, spreading the risk exposure
- Popular mutual funds include: Exchange traded funds (ETFs) and Hedge Funds
- **Exchange traded funds:** behave like index tracking mutual funds and trade all day in stock exchanges
- **Hedge funds:** private investment partnership whose shares are offered primarily to wealthy individuals and major institutions
 - ✓ Often make high stakes bets on the direction the market will take
 - ✓ Supplying for venture capitals

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So, in this context, we have mutual funds already all of you have the idea about this. So, this has been basically a kind of fund which has the common objective, it is a pool of the fund with a common objective. So, in this context this has been attractive over the periods because it is professionally managed and the lack of financial knowledge may not hamper or may not create any kind of obstacle, if anybody wanted to invest in the mutual fund.

So, mutual funds have been attractive to many individuals or the institutional investors because of long run yields, which are appeared to be relatively high and the most funds are diversified because it is professionally managed and the popular mutual funds which are available there are many ways the mutual funds can be defined.

But they are traded basically in the exchange traded market or exchange traded funds and hedge funds is a type of mutual fund, it is what, there is many differences in terms of, mutual fund is a small savings, but the hedge funds are basically is a very large amount of investment required. If anybody wants to invest in the hedge funds and hedge funds are less regulated but mutual funds are highly regulated and the hedge fund market in India is very under developed.

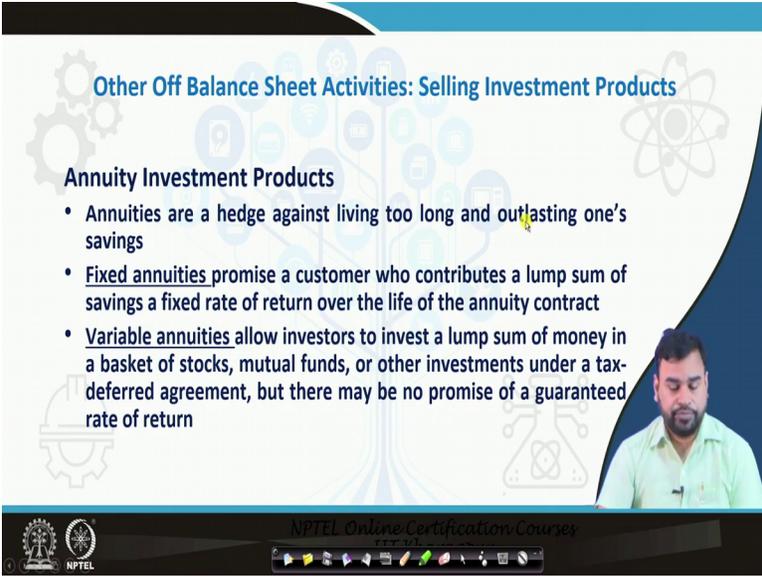
But mutual funds is quite popular in the Indian financial system. As an important segment of the financial market and there are many types of mutual funds already, all of you might have known that, that is a growth fund that is income fund, there is a balanced fund. It depends upon the

different kind of combination of the assets what the mutual funds have. Then we can also divide the mutual funds and open ended fund and the close ended fund. The close ended funds cannot be redeemed without majority.

But the open ended funds can be redeemed at any point of time and the close ended fund are basically traded in the market, what the open ended funds are not. So, these are the different differences between these. The exchange traded funds behave like an index which is tracking a mutual funds and trade all day in the stock exchanges.

But in the hedge fund, it is a private investment partnership. Shares are offered primarily to all the individuals. Just now what I was sharing with you and the major institutions, often make high stakes bets on the direction the market will take and supplying for the venture capitalist. So, hedge funds investment is relatively riskier than the investment what we make in the mutual fund case. So, this is what the kind of another product services, what the commercial banks can provide to maximize their revenue and as well as to satisfy the customer's requirements.

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The slide is titled "Other Off Balance Sheet Activities: Selling Investment Products". It features a list of "Annuity Investment Products" with three bullet points. The background of the slide is light blue with faint icons of gears and a molecular structure. A small video inset of a man in a green shirt is visible in the bottom right corner of the slide. At the bottom of the slide, there is a logo for NPTEL and a navigation bar for an online certification course.

Other Off Balance Sheet Activities: Selling Investment Products

Annuity Investment Products

- Annuities are a hedge against living too long and outlasting one's savings
- **Fixed annuities** promise a customer who contributes a lump sum of savings a fixed rate of return over the life of the annuity contract
- **Variable annuities** allow investors to invest a lump sum of money in a basket of stocks, mutual funds, or other investments under a tax-deferred agreement, but there may be no promise of a guaranteed rate of return

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Then we have the Annuity Investment Products. These are the products which are used hedge against living too long, which provides a regular flow of income for indefinite period of time and outlasting one's savings basically. Then fixed annuity promises a customer who contributes a lump sum of savings, a fixed rate of return over a life on the annuity contract, a fixed rate up to

the whole lifetime, up to indefinite period of time, this particular cash flow will be available, a lump sum amount will be deposited in the beginning and that will carry out certain kind of return over a long period of time.

But the variable annuities basically allows the investors to invest a lump sum money in the basket of the stocks, mutual funds and other investments under a tax deferred agreement. But there may be no promise of the guaranteed rate of return. So, in case of fixed annuity there is a guaranteed rate of return which is fixed from the beginning.

But in terms of the variable annuities, there is no guarantee and the money which is deposited against that, that can be invested in any of the financial assets which are traded in the market. So, that is basically called the variable annuities fund.

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Other Off Balance Sheet Activities: Selling Investment Products

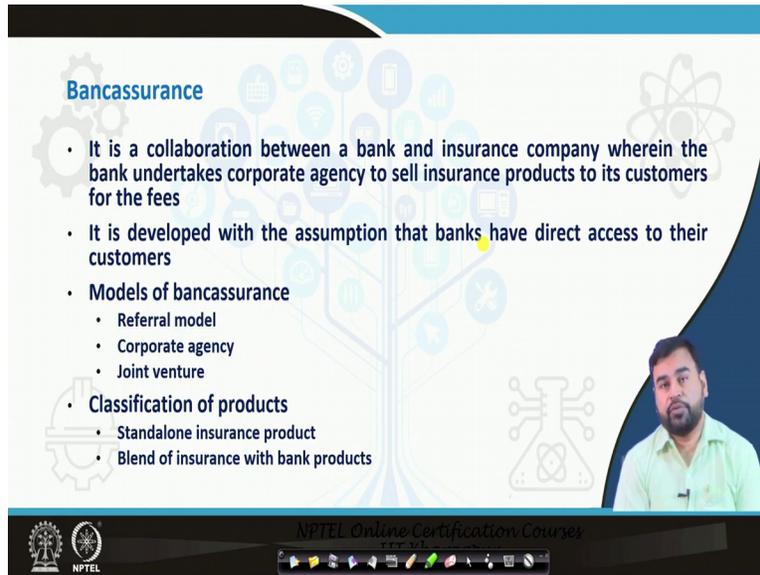
Annuity Investment Products

- Recently a new type of annuity contract has appeared, the equity-index annuity
- Combines the features of both fixed and variable annuities
- One advantage for financial firms selling this service is that annuities often carry substantial annual fees
- One significant disadvantage with annuities sold through depository institutions is they typically compete with selling deposits

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So, recently a new type of annuity contract has appeared that is the equity index annuity that is in US. It combines both the features of both fixed and variable annuities. One advantage of the financial firm selling this service is that annuities often carry substantial annual fees. That is why the commercial banks can do this business. But one significant disadvantage is that with annuities sold through depositories institutions is they typically compete with the other selling deposits, so that product itself is a competitor of another product. So, because of that it has certain kind of disadvantage with respect to the depository institutions which exist in the system.

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Bancassurance

- It is a collaboration between a bank and insurance company wherein the bank undertakes corporate agency to sell insurance products to its customers for the fees
- It is developed with the assumption that banks have direct access to their customers
- Models of bancassurance
 - Referral model
 - Corporate agency
 - Joint venture
- Classification of products
 - Standalone insurance product
 - Blend of insurance with bank products

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Then we have another kind of instrument, what we use that is called bancassurance. That means the banks are basically selling the insurance product. So how basically they do it, they can do it with a collaboration with insurance company where the bank basically undertakes the corporate agency to sell this insurance product to its customers and they charge some fees against that and why it is developed, it is developed because everybody has the idea.

The bank has direct access to the customer and the customer base of the banks is larger. So, because of that selling this insurance product to the different customer through the banks is relatively easier and against that the bank can generate some revenue out of this. There are different models through which this particular product works. One is referral model. The bank can refer a particular insurance product to the customer to buy by highlighting certain benefits of that or they can directly act as a corporate agency that with certain kind of fees.

Then accordingly, they can sell that product through them or they can have a joint venture with an insurance company and develop certain kind of product. In India, which is popularly used by the different banks. Where the bank insurance products are basically used in the context of a joint venture company, where the product is designed in such a way, which are mostly fulfilling the criteria for the insurance product what sold by the commercial banks.

So, there are classification of the product in terms of the bank insurance that is a standalone insurance product and also there are, there are some product which are available, which is a combination of insurance products and the bank products. So, this is the way basically the, another kind of off-balance sheet activities, the commercial banks can carry out and through that, they are able to generate certain kind of extra revenue.

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CONCLUSION

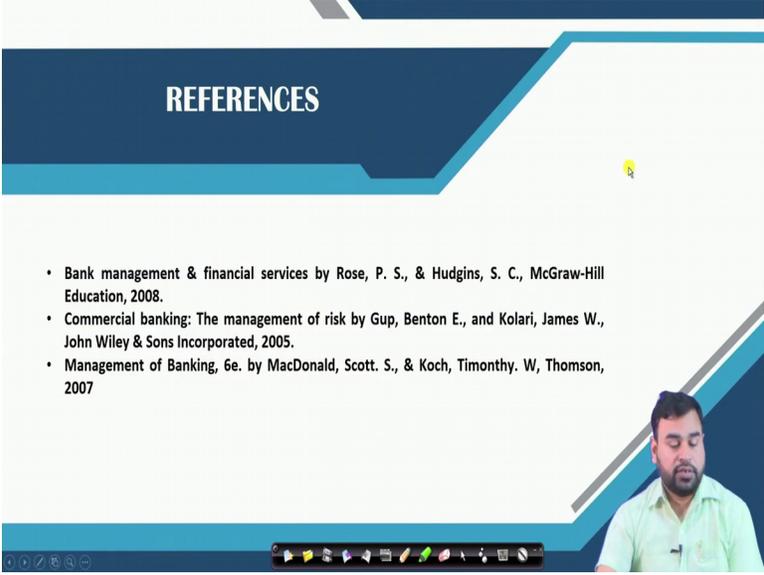
Other off-balance sheet items are loan sales, acceptance participation, investment banking services, mutual fund and insurance services etc.

All these activities help the banks to diversify the risk and increase the income

So, in this session what we have discussed, there are many off balance sheet items. We have loan sales acceptance, participation, investment banking, mutual fund, insurance all kinds of things also provided by the banks and because they are not the regular flow of income, what they get that can be considered as the off-balance sheet items in this and through this, the bank is able to manage the whole banking activity and as well as it has the implications on the balance sheet and all these activities also help the bank to diversify the risk and increase the income overall income of the commercial bank.

So, this is the way basically off-balance sheet items really play the significant role for the commercial banks and in terms of maintaining liquidity and as well as the profitability.

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These are the references, what you can go through for this particular session. Thank you.