

PPB — Principles & Practices of Banking

Complete Book | Table of Contents | 56 chapters + 4 sections

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LEARNING
SESSIONS

CH-1

Banker-Customer Relationship

Topic 1 — Banker and Banking

- **Definition** — Section 5(b) of the Banking Regulation Act, 1949 defines **banking**.
- **Deposits** — Banking means accepting deposits of money from the **public**.
- **Purpose** — The deposits are accepted for **lending or investment**.
- **Repayment** — Deposits are **repayable on demand or otherwise**.
- **Withdrawal** — They are **withdrawable by cheque, draft, order or otherwise**.
- **Banker** — A banker is the institution that carries on this business.

Aspect	Coverage
Ancillary functions	Remittances, lockers, safe custody of articles, forex, discounting of bills, non-fund based credit facilities (guarantees, LCs)
Obligations and duties	Duty to honour cheques (when funds are sufficient and the cheque is in order); duty to maintain secrecy of customer accounts

Topic 2 — Bank Licensing and Place of Business

A banking company can carry on banking business in India only with a **licence from RBI under Section 22** of the BR Act. Mere incorporation as a company does **not** authorise it to accept banking deposits.

Provision	Requirement
Section 22 – Licence	RBI examines ability to pay depositors, conduct of management, adequate capital and earning prospects, public interest and interest of the banking system
Section 23 – Place of business	Prior RBI permission (subject to applicable authorisations) is needed to open a new place of business; licence and branch permission are distinct

Banking Laws (Amendment) Act, 2025

- **Purpose** — The **Banking Laws (Amendment) Act, 2025** modernised the BR Act.
- **Substantial interest** — Threshold raised from ₹5 lakh to **₹2 crore**, or 10% of paid-up capital, whichever is lower.
- **Nominees** — Up to **four nominees** allowed for deposits, lockers and safe custody, from **1 November 2025**.
- **Reporting dates** — Regulatory reporting dates moved to the **15th and last day** of the month.
- **Co-operative bank directors** — Maximum tenure raised to **10 years**, other than chairperson and whole-time director.

Topic 3 — Customer

- **No statutory definition** — The BR Act does not define a customer.
- **KYC definition** — Under the **RBI (Commercial Banks – KYC) Directions, 2025**, a customer is a person **engaged in a financial transaction or activity with a Regulated Entity**.
- **Includes** — It also covers a person **on whose behalf** such person is acting.
- A customer relationship arises through an account or an accepted banking service; duration of dealing is not essential.
- An **introducer is not a legal condition** for becoming a customer. Identification, verification and **risk-based customer due diligence** under KYC rules apply instead.

- The bank's role changes with the service: **debtor** for deposits, **creditor** for loans, **bailee** for goods kept in safe custody.

Topic 4 — Termination of Banker-Customer Relationship

By act of parties	By operation of law
Customer closes the account	Death of the customer
Bank closes the account (after due notice)	Insanity or insolvency of the customer

- **See** — Ch 18 (p. 61) for the bank's action on each event that ends the relationship.

Topic 5 — Types of Banker-Customer Relationship

Debtor-creditor is the basic relationship. When a customer deposits money, the bank becomes the **debtor** and the customer the **creditor**; when the bank lends, the roles reverse.

- **Trustee-beneficiary** — The bank is a **trustee** when a customer deposits money or securities with **specific instructions to use them for a specific purpose**.
- **Trust arrangement** — The bank is also a trustee when it acts under a trust arrangement.
- **Bailment** — Goods delivered for safekeeping create **bailment**. A bailee is not the same as a trustee.

Bailor-bailee: a bailee temporarily holds possession of another's property (the bailor's) for a **specific purpose and period** and must take **reasonable care** of it.

Agent-principal: for ancillary services such as remittances, collection of cheques and bills, and **standing instructions**, the bank is the **agent** and the customer the **principal**.

- **Lessor-lessee** — The lessor owns the asset and gives it to the lessee for use against periodic lease rentals.
- **Operating leases** — These are short-term.
- **Financial leases** — These are long-term, with ownership-transfer options.

Indemnifier-indemnified: the indemnifier (customer) agrees to compensate the indemnified (bank) for loss arising from specific acts, e.g. an **indemnity bond** for issue of a **duplicate demand draft**.

Relationship	Bank	Custo mer	Situation
Debtor-Credi tor	Debtor	Creditor	Customer deposits money in savings or fixed deposit
Creditor-Deb tor	Creditor	Debtor	Bank grants loan or overdraft
Trustee-Ben eficiary	Trustee	Benefici ary	Bank acts as trustee for customer's will or trust fund
Agent-Princi pal	Agent	Principa l	Bank collects a cheque or bill for the customer
Bailee-Bailor	Bailee	Bailor	Customer delivers valuables for safe custody
Bailor-Bailee	Bailor	Bailee	Bank releases pledged gold or documents to the customer for temporary use
Lessor-Less ee	Lessor	Lessee	Bank leases equipment or property to the customer
Lessee-Less or	Lessee	Lessor	Customer leases premises to the bank for a branch
Indemnified-I ndemnifier	Indemni ty holder	Indemni fier	Customer indemnifies bank for duplicate DD
Beneficiary-Guarantor	Benefici ary	Guarant or	Customer guarantees a third party's loan
Custodian-C ustomer	Custodi an	Custom er	Bank holds securities in demat account

Relationship	Bank	Custo mer	Situation
Advisor–Clien t	Advisor	Client	Bank advises on investment or wealth management

Topic 6 — Demand, Time and Hybrid Deposits

Aspect	Demand deposits	Time deposits
Nature	Withdrawable any time without notice	Placed for a fixed period ; withdrawal before maturity as per disclosed terms (penalty)
Liquidity	Highly liquid	Less liquid
Interest	Low (savings) or nil (current)	Higher
Purpose	Day-to-day transactions and business needs	Long-term savings and investment
Examples	Savings, current accounts	Fixed deposits, recurring deposits

Hybrid or flexi deposits combine demand and fixed deposits (e.g. auto-sweep), giving liquidity with higher interest.

Topic 7 — Deposit Products for Non-Resident Indians

Feature	NRO	NRE	FCNR(B)
Forms	Savings, current, RD, FD	Savings, current, RD, FD	Term deposits only, 1 to 5 years
Purpose / credits	Legitimate Indian income – rent, dividend, pension, interest	Foreign remittances and eligible repatriable funds	Foreign remittances, incl. sale proceeds of FDI
Joint holding	With residents permitted	With resident close relative on former or survivor basis; NRI must open personally, not through power of attorney	With other NRIs; also with a resident close relative on former or survivor basis

- There is no wealth tax at present.
- **See** — Ch 9 (p. 35) for NRO, NRE and FCNR(B) currency, repatriation, interest, tax and loan rules; Ch 10 (p. 40) for transfer of FCNR(B) balances to an RFC account on becoming resident.

Topic 8 — Merchant Banking

- **Meaning** — Merchant banking is a specialised segment providing **advisory, capital-raising and financial management** services.
- **Clients** — It serves corporates, HNWI and institutions.
- **Difference** — Unlike traditional banking, it does **not** involve general deposit-taking or retail lending.

Service	Scope
Corporate advisory	Mergers, acquisitions, joint ventures; structuring and negotiating deals
Underwriting of securities	Raising equity or debt; underwriting shares in IPOs and rights issues
Project financing	Advice on large projects; arranging syndicated loans
Portfolio management	Managing portfolios of HNWI and institutions with tailored strategies
Foreign exchange management	Managing forex transactions and forex risk
Private placement	Raising funds from private investors, avoiding public markets

Service	Scope
Debt restructuring	Renegotiating or restructuring corporate debt

Leading global merchant banks include Goldman Sachs, J.P. Morgan and Morgan Stanley.

Topic 9 — Lease Financing

- **Meaning** — The owner of an asset (**lessor**) lets another party (**lessee**) use it for a specified period.
- **Payment** — The lessee pays **periodic payments** for the use.
- **Ownership** — **Ownership remains with the lessor**. The lessee gets only the right to use.
- **Banks as lessors** — Banks often lease machinery, equipment and vehicles.

	Lessee (customer)	Lessor (bank)
Advantages	No large upfront cost; preserves working capital; flexibility of term; lease rentals tax-deductible as expense; easy upgrade to new technology	Steady income stream; retains ownership (lower default risk); market expansion to customers not eligible for loans; tax benefit of depreciation
Disadvantages	Higher long-term cost; no ownership; usage and maintenance restrictions; early termination penalties	Asset depreciation risk; default risk; administrative (maintenance, monitoring, legal) costs; lower profitability than loans if terms uncompetitive

Example: A bank leases machinery to a customer for 5 years against monthly rentals. At the end the customer may return, renew or purchase the machinery.

Topic 10 — Plastic Money

Plastic money means payment cards that enable **non-cash** transactions – purchases, cash withdrawal and access to financial services.

Card	Source of funds	Repayme nt	Key feature	Costs / limitation
Charge card	Issuer credit	Full payment at end of billing cycle	No interest; promotes discipline	Membership fee; heavy penalty for delay; no partial payment
Credit card	Credit within limit	Full or partial (minimum due)	Interest-free period (typically 20–50 days); rewards	High interest on unpaid balance; annual fee
Debit card	Linked bank account	Immediate debit	No borrowing; online, POS, ATM use	Limited to account balance
ATM card	Linked bank account	Immediate debit	Cash withdrawal, balance enquiry at ATMs	Limited functionality
Prepaid card	Preloaded value	No repayment	Not linked to account; reloadable or not; gift, travel, wallets	Limited to loaded balance; reload or inactivity fee
Co-branded card	Credit or balance	As per card type	Issued with a partner (airline, retailer, fuel)	Limited utility outside partner

**Topic 11 — Other Banking Services**

Service	Description
Demat account	Holds securities (shares, bonds, mutual fund units) in electronic form
Trading account	Used to buy and sell securities on stock exchanges
Three-in-one account	Savings + demat + trading account combined
Mutual funds	Pooled investments managed by professionals; investors buy units
Escrow account	Funds or assets held by a neutral third party until pre-defined conditions are met
Escrow of documents	Bank holds important documents until contractual conditions are met
Trusteeship	Fiduciary management of assets for the benefit of a third party
Executorship	Executing the will of a deceased person – asset distribution and debt settlement

PPB | Module A | CH-1 | MCQs

Q1. A newly incorporated company proposes to accept deposits from the public for lending. Under the BR Act, it can commence this business only after: [Ref: Topic 2, p. 3]

- (a) Obtaining a licence from RBI under Section 22
- (b) Registration with the Registrar of Companies
- (c) Obtaining permission under Section 23
- (d) Approval of the Ministry of Finance

Q2. Which element is NOT part of the definition of banking under Section 5(b) of the BR Act? [Ref: Topic 1, p. 3]

- (a) Acceptance of deposits from the public
- (b) Deposits for the purpose of lending or investment
- (c) Granting of insurance cover to depositors
- (d) Deposits withdrawable by cheque, draft or order

Q3. Ravi wishes to open an account but knows no existing customer to introduce him. The bank should: [Ref: Topic 3, p. 3]

- (a) Refuse the account for lack of introduction
- (b) Open the account after completing KYC and customer due diligence
- (c) Open it only as a small account
- (d) Ask him to obtain a police verification

Q4. Which event automatically terminates the banker-customer relationship? [Ref: Topic 4, p. 3]

- (a) Death of the customer
- (b) Customer shifting residence
- (c) Customer's account becoming inoperative
- (d) Issue of a garnishee order nisi

Q5. When a customer places gold ornaments with a bank in safe custody, the relationship is: [Ref: Topic 5, p. 3]

- (a) Debtor and creditor
- (b) Trustee and beneficiary
- (c) Agent and principal
- (d) Bailee and bailor

Q6. A customer submits an indemnity bond to obtain a duplicate demand draft. Here the customer is the: [Ref: Topic 5, p. 3]

- (a) Indemnity holder
- (b) Bailee
- (c) Guarantor
- (d) Indemnifier

Q7. Which pair correctly shows the roles when a customer leases his building to a bank for a branch? [Ref: Topic 5, p. 3]

- (a) Bank – lessor; customer – lessee
- (b) Bank – lessee; customer – lessor
- (c) Bank – bailee; customer – bailor
- (d) Bank – trustee; customer – beneficiary

Q8. Which statement about demand deposits is correct?

[Ref: Topic 6, p. 4]

- (a) Withdrawal requires notice
- (b) They are not liquid
- (c) They earn higher interest than term deposits
- (d) Current accounts usually earn no interest

Q9. An NRI wants to open a joint NRE account. Which is permitted? [Ref: Topic 7, p. 4]

- (a) Joint with any resident on either or survivor basis
- (b) Opening through a power of attorney holder in India
- (c) Joint with a resident close relative on former or survivor basis
- (d) Opening only in foreign currency

Q10. An NRI receives rent from his flat in Pune. The appropriate account to credit this income is: [Ref: Topic 7, p. 4]

- (a) NRO account
- (b) FCNR(B) account
- (c) NRE account
- (d) RFC account

Q11. A depositor wants a 7-year FCNR(B) deposit in US dollars. The bank should advise that: [Ref: Topic 7, p. 4]

- (a) FCNR(B) can be held only in rupees
- (b) FCNR(B) is available only as savings account
- (c) FCNR(B) deposits can be only for 1 to 5 years
- (d) There is no maximum tenor

Q12. A company needs advice on an acquisition and underwriting of its IPO. Which service suits it? [Ref: Topic 8, p. 4]

- (a) Retail banking
- (b) Merchant banking
- (c) Correspondent banking
- (d) Lease financing

Q13. Which is a disadvantage of leasing from the lessee's point of view? [Ref: Topic 9, p. 4]

- (a) Lack of ownership even after paying rentals
- (b) Need for large upfront payment
- (c) Inability to use the asset
- (d) Depreciation risk

Q14. A cardholder must clear the entire bill at the end of each billing cycle and cannot roll over dues. The card is a: [Ref: Topic 10, p. 4]

- (a) Credit card
- (b) Debit card
- (c) Charge card
- (d) Prepaid card

Q15. Funds deposited by a buyer are held by a bank until the seller delivers goods as per contract. This is a/an: [Ref: Topic 11, p. 5]

- (a) Demat account
- (b) Trading account
- (c) Escrow account
- (d) Nostro account

Answer key

Q	Ans	Q	Ans	Q	Ans	Q	Ans	Q	Ans
1	a	4	a	7	b	10	a	13	a
2	c	5	d	8	d	11	c	14	c
3	b	6	d	9	c	12	b	15	c

CH-2 AML KYC Guidelines

Topic 1 — Stages of Money Laundering

Money laundering is the process of making illegally obtained money appear legitimate. It passes through three stages.

Stage	What happens	Techniques
Placement	Illicit cash first enters the financial system; aim is to avoid detection	Cash deposits; breaking large sums into small deposits (structuring / smurfing); buying assets such as real estate or luxury items
Layering	Origin is concealed through a complex series of transactions; aim is to obscure the trail	Transfers across many accounts and jurisdictions; shell companies and offshore accounts; investing in financial instruments or high-value goods
Integration	Laundered money re-enters the legitimate economy and appears legally earned	Investing in businesses or real estate; buying legitimate assets; declaring it as business income

Remember this

- Order of stages: **P-L-I** – Placement, Layering, Integration

Topic 2 — Stages of Terrorist Financing

Stage	Description
Raising	Funds collected from legal (donations, charities) or illegal (smuggling, drug trafficking) sources
Moving	Transferred through hawala, banking channels or cash smuggling to avoid detection
Storing	Held in cash, bank accounts or assets until required
Using	Deployed for weapons, logistics, recruitment or propaganda

Aspect	Money laundering	Terror financing
Objective	Conceal origin of illicit funds	Support terrorist activities
Source of funds	Proceeds of crime only	Legal (donations) or illegal sources
Focus	Making dirty money look clean	Ensuring funds reach and are used for terror acts
Legal framework	AML laws	Counter-terrorism financing (CFT) laws

Topic 3 — Objectives of Prevention of Money Laundering

- Protect the **integrity of the financial system** from misuse.
- Combat financial crime by cutting off access to illicit proceeds.
- Prevent **terrorism financing**.
- Enforce domestic and international AML laws.
- Promote **economic stability** by preventing market distortion.
- Safeguard **national security** against financial empowerment of criminals and terrorists.
- Encourage ethical business practices and accountability.
- Facilitate **cross-border co-operation**.
- Promote **financial inclusion** by building trust in the system.
- Deter future crime by penalties and confiscation of illicit gains.

Topic 4 — Legal Framework – PMLA, 2002

- Basis** — The **Prevention of Money Laundering Act, 2002 (PMLA)** is based on **FATF** recommendations.
- Coverage** — It covers financial and non-financial businesses designated as **Reporting Entities (REs)**.
- Rules** — RE obligations are detailed in the **Prevention of Money Laundering (Maintenance of Records) Rules, 2005 (PMLR)**.

Provision	Content
Section 3 – Offence	Covers anyone who directly or indirectly attempts, knowingly assists, is knowingly a party or is actually involved in any activity linked to proceeds of crime . Includes concealing, possessing, acquiring, using or claiming it as untainted.
Section 4 – Punishment	Rigorous imprisonment of minimum 3 years, maximum 7 years ; up to 10 years where proceeds relate to an offence under paragraph 2 of Part A of the Schedule (NDPS offences); plus fine
Section 45	Offences are cognizable and non-bailable
Section 12AA	Enhanced due diligence before specified transactions
Section 13	Penalty by Director, FIU-IND

Topic 5 — Money Laundering Risk Perception

Criminals exploit banking products to launder money and finance terrorism by masking identities and activities.

Example: A gambling operator routes betting receipts into his account posing as a freelancer to disguise their source.

Risk factor	Coverage
Customer profile	True identity, purpose and profile of the customer may be misrepresented
Other factors	Nature of products and services; country of incorporation of the bank; location of branch and connected transactions; nature and value of transactions

Topic 6 — Measures and Institutional Framework

- Under PMLA banks must **know their customers, detect and report suspicious activity to FIU-IND**, comply with laws, and **train staff** in KYC/AML.
- Risks are mitigated by monitoring activity and discouraging criminal misuse of services.

Institution	Role
FIU-IND	Receives and analyses transaction reports; supervises REs under PMLA; Director FIU-IND imposes penalties
Enforcement Directorate	Investigates and prosecutes money laundering; attaches assets linked to offences
Special Courts	Try money laundering cases; order freezing and confiscation
Regulators (RBI, SEBI, IRDAI etc.)	Issue operating guidelines for compliance with PMLA and PMLR

Topic 7 — Organisational Set-up for AML

PMLR requires banks to set up an organisational structure for AML/CFT obligations, with clearly assigned roles.

Role	Responsibilities and designation
Designated Director (DD) – duties	Ensures overall compliance with PMLA, PMLR and RBI directions. Supervises KYC/AML systems and keeps KYC Policy updated. Ensures skilled staff and adapts measures to changing ML/TF risk.