**Commercial Banking System & Role of RBI**

**September 2024 Examination**

**Q1. ‘The role of a Central bank is very crucial for the efficient functioning of any banking system’. Discuss the relevance of this statement highlighting the objectives of a central bank. Also in the context of the Indian banking system, name the central bank and discuss what different role and function are performed by the Central bank? (10 Marks)**

**Ans 1.**

**Introduction**

Central banks serve as the backbone of any nation's financial system, influencing economic outcomes through their role in monetary policy, financial stability, and regulatory oversight. The central bank not only regulates the money supply and interest rates but also ensures the smooth functioning of the banking sector. In India, the Reserve Bank of India (RBI) functions as the central bank, playing a critical role in the country's economic governance. It is instrumental in maintaining monetary stability, ensuring financial solvency, and fostering sustainable economic growth. The RBI's extensive mandate covers everything from issuing currency to regulating and supervising financial institutions, positioning it as a key player in India's economic resilience and

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**Q2. The banking sector is very closely related to the financial markets in the financial system and hence baking operations faces many risk scenarios. Enlist and explain the different risks that commercial banks face in their business operations. (10 Marks)**

**Ans 2.**

**Introduction**

Commercial banks are integral components of the global financial system, acting as intermediaries that mobilize funds from savers to borrowers. However, this crucial role exposes them to a spectrum of risks. These risks arise from various sources including fluctuations in market conditions, changes in regulatory landscapes, and operational challenges. Identifying and managing these risks is paramount for the stability and profitability of banks. As financial markets become more interconnected, the potential for systemic risks increases,

**Q3. Lending is one of the two main functions of commercial banks. The lending process involves due diligence to ensure efficient appraisal of the participants to whom lending is provided. Discuss the following mechanisms of credit appraisal of commercial banks**

**a Discuss the concept of Credit rating of a Loan account. (5 Marks)**

**Ans 3a.**

**Introduction**

Lending represents a fundamental activity for commercial banks, enabling them to generate revenue while supporting economic growth. An integral part of the lending process is the credit appraisal, a meticulous assessment conducted to determine the creditworthiness of potential borrowers. This process reduces the risk of defaults and ensures the sustainability of the bank’s loan portfolio. Among the various mechanisms of credit appraisal, the concept of credit rating of a loan

**b. Discuss the concept of a Letter of Credit. (5 Marks)**

**Ans 3b.**

**Introduction**

In the realm of international trade, a Letter of Credit (LC) is a pivotal financial instrument that facilitates transactions between buyers and sellers who may be operating under different legal, cultural, and economic conditions. This document, issued by a bank, acts as a guarantee to the seller that payment will be made once the conditions stated in the LC are fulfilled. It serves to mitigate risks associated with the non-fulfillment of contractual obligations, especially in cross-