

# Notes on Fund Based & Non Fund Based Services and their Types

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In fund based lending - The lender give physical money for use and may be in name of overdraft, cash credit hypothecation, pledge, packing Credit, export credit, education loan, crop loan, housing loan, car loan etc.

Whereas in non fund based credit, there is no involvement of physical money and it is given in form of commitment by signing documents. Best examples are Bank Guarantee (BG), Letter of Credit etc.

Fund based lending, where the lending bank commits the physical outflow of funds. The various forms in which fund based lending may be made by banks:

a.) **Loan** is a type of fund based lending. It is a single advance in which the entire amount of assistance is disbursed at one time only, either in cash or by transfer to the borrower's account. The loan is generally provided at a cost i.e. interest. The loan amount is paid back in regular installments, or partial repayments, in an annuity, each installment is the same amount.

b.) **Over draft** is a type of fund based lending. It occurs when money is withdrawn from a bank account and the available balance becomes nil. In this situation the account is said to be overdrawn. Thus under this facility, the company is allowed to withdraw in excess of the balance standing in bank account. Bank fixes a limit beyond which the company will not be able to overdraw the account. Legally, overdraft is a demand assistance given by the bank. It is given for a very short period of time, at the end of which the company is supposed to repay the amount. Interest is payable on the actual amount drawn.

c.) **Cash credit** is a short term cash loan to a company. It is just like overdraft facility except there is no need to open a formal current account. Also, this type of funding requires security deposit to secure the loan given by the bank. Legally, cash credit is a demand facility. Interest is payable on actual amount drawn.

d.) **Bills Purchased/** discounted facility enables the company to get the immediate payment against credit invoices raised by the company. The bank holds the invoices till the customer has

actually made the payment. While granting this facility, the bank first satisfies itself about the credit worthiness of the customer and the genuineness of the bill. A limit has been fixed in case of the company beyond which the bills are not purchased or discounted by the bank.

e.) **WC Term loans** are a short term business loan that is commonly used to help businesses which are experiencing cash flow problems. To meet the working capital needs of the company banks may grant the working capital term loans for a period of 3 to 7 years, payable in yearly or half yearly installments.

f.) **Packing credit** is the type of assistance given by the bank to enable the company to buy the goods to be exported. This type of facility is included in short term facilities. Packing credit facility is in two forms:

- Pre-shipment Packing Credit
- Post-shipment Packing Credit

**Non fund based lending**, where the lending bank does not commit any physical outflow of funds. The funds position of the lending bank remains intact.

a.) **Bank Guarantees** - Bank Guarantee is a non-fund based lending given by the bank to ensure that the liabilities of a debtor will be met. This facility enables the customer to acquire goods, buy equipment and thereby expand business activity.

b.) **Letter of Credit** - Letter of Credit is a non-fund based lending which is very regularly found in international trade.

This facility is given when the exporter and importer are unknown to each other. In this case, the importer applies to his bank (Issuing Bank) in his country to open a letter of credit in favour of exporter whereby the importers' bank undertakes to pay the exporter on fulfilling the terms and conditions specified in the letter of credit.