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SCHOOL OF MANAGEMENT STUDIES

UNIT – 1 – BANKING AND INSURANCE MANAGEMENT – SBAA7001

UNIT 1 INDIAN BANKING SYSTEM

Banking basics – Structure of Indian banking system – Types of Banks – Role and functions of Bank – Role of commercial banks as a Financial Intermediary – RBI and its role as the central bank – Recent developments in Banking Sector: Core Banking, E-Banking – Impact of Technology in Banking Sector – Payment Banks.

Introduction

Finance is the life blood of trade, commerce and industry. Now-a-days, banking sector acts as the backbone of modern business. Development of any country mainly depends upon the banking system. A bank is a financial institution which deals with deposits and advances and other related services. It receives money from those who want to save in the form of deposits and it lends money to those who need it. It deals with deposits and advances and other related services like lending money to grow the economy. Banks act as bridge between the people who save and people who want to borrow i.e., It receives money from those people who want to save as deposits and it lends money to those who want to borrow it. The money you deposited in bank will not be idle. It will grow by means of interest to your bank account they will earn interest in return for lending out the samemoney.

History of Banking

The earliest example of banking activities has been recorded at various times in ancient history. During 2000 BCE, in Babylonia, temples were the center of economic activity as trade was limited to the internal borders. Both palaces and temples issued loans and wealth to the people.

Ancient Greece was more sophisticated in their banking system as the lenders based in temples not only provided loans but also deposited and offered change of money. Merchants used goldsmiths vault to store their wealth and gold in exchange for a fee. With passing time, goldsmiths started lending money to people. The first bank to open in the world is Banca Monte deiPaschi di Siena, established by Giovanni Medici in 1397, Italy. This bank is headquartered at Siena, Italy and continues to operate. Meanwhile, modern banking practices emerged in the 17th and 18thcenturies.

When it comes to ancient India, there is proof of banking activities in the form of the lending system during the Vedic period. However, modern banking in India emerged in the last decade of the 18th century when the very first bank of India originated. Bank of Hindustan was established in the year 1770 and dissolved in 1829. General Bank of India was the second bank to establish in India in the year 1786 and liquidated in 1791. It was Bank of Calcutta that was incepted in the year 1806 and grew to become the largest bank of India that still exists in the form of State Bank ofIndia.

This was one of the three banks founded by presidency government of India. The other two were Bank of Bombay and Bank of Madras. All three were merged into Imperial Bank of India in 1921. Years after independence, it became State Bank of India. As for Reserve Bank of India, it was established and registered under the Reserve Bank of India Act, 1934, in 1935. It was in 1949 when Banking Regulation Act was enacted, RBI was made the apex bank that could control, regulate and, monitor the banks ofIndia.

Under the nationalization phase, the Indian banking industry was recognized as an important instrument of development of economy, especially after the independence. During the first phase of nationalization, the Government of India nationalized 14 banks in 1969. This includes Allahabad Bank, Bank of Baroda, Bank of India, Bank of Maharashtra, Central Bank of India, Canara Bank, Dena Bank, Indian Bank, Indian Overseas Bank, Punjab National Bank, Syndicate Bank, UCO Bank, Union Bank, and United Bank of India.

In the second wave of nationalization, six more banks were nationalized in the year 1980. These banks were Punjab and Sind Bank, Vijaya Bank, Oriental Bank of India, Corporate Bank, Andhra Bank, and New Bank of India.

Another landmark movement for the Indian Banking industry was liberalization in the 1990s. During this time, the government opened the economy for private and foreign banks. These banks were termed as New Generation tech-savvy banks. This move along with technological development and rapid growth of the Indian economy caused a massive transformational shift in the banking sector. Banks started adopting technology and opened itself to new opportunities.

In 1984, MICR technology was introduced. In the year 1988, the computerization of banks started. Since then the industry has experienced massive technological upliftment. There has been a digital revolution of sorts that has changed Indian banking system from conventional banking to convenient banking. Over the decades, banks have developed enormously with the help of information technology and artificial intelligence.

Recently, Indian Government created another milestone in the development of Indian banking industry by launching online payment systems United Payments Interface (UPI) and Bharat Interface for Money (BHIM) by National Payments Corporation of India (NPCI). Today, banks in India aim to provide fast, accurate, and quality banking experience to their customers with the help of internet banking and online banking.

Origin of the word 'Bank'

The word Bank is derived from

- Greek –Banque
- French – Banke means chest(deposits)
- German – Banck means heap or mound (a group/collection ofthings
- Italians - Banco means accumulation of money orStock

It referred to a bench for keeping, lending and exchanging of money or coins in the market place by money lenders and money changers.

Bank - Meaning

A bank is a financial institution which deals with deposits and advances and other related services. It receives money from those who want to save in the form of deposits and it lends money to those who need it. It deals with deposits and advances and other related services like lending money to grow the economy. Banks act as bridge between the people who save and people who want to borrow i.e., It receives money from those people who want to save as deposits and it lends money to those who want to borrow it. The money you deposited in bank will not be idle. It will grow by means of interest to your bank account they will earn interest in return for lending out the same money to borrowers. This would ensure smooth money flow to develop our economy.

Banking - Definition

Chamber's Twentieth century Dictionary defines a bank as, "an institution for the keeping, lending and exchanging etc. of money".

According to **Banking Regulation Act**, "Banking means the accepting for the purpose of lending or investment of deposits of money from the public, repayable on demand or otherwise and withdrawable by cheque, draft, and an order orotherwise".

Oxford Dictionary defines a bank as "an establishment for custody of money, which it pays out on customer's order."

Prof. Kent defines a bank as, "an organization whose principal operations are concerned with the accumulation of thetemporarily".

Section5 (b) of Banking Regulation Act, 1949 (BR Act): According to BRAct. "Banking means accepting, for the purpose of lending or investment, of deposits of money from the public, repayable on demand or otherwise, and withdrawable by cheque, draft, and order or otherwise." "Banking Company "means any company which transacts the business of banking in India.Companymeansanycompanyasdefinedinofthe CompaniesAct, 2013 and includes a foreign company within the meaning of thatAct.

Difference between Bank andBanking

Sl.No.	Factors	Bank	Banking
1	Nature	Bank is a financial intermediary institution	Banking is the summation of all activities of bank.
2	Organizational Structure	Banking may be sole proprietorship, partnership orany other form of organization	Banking has no Organo gram
3	Functions	Bank performs the banking functions	Collection of deposits, granting loans etc is the functions of banking.
4	Liability	Banker is liable for the Bank's	Bank is liable for the banking

		activities	activities.
5	Success	Success of bank depends on the efficiency of the banker	The success of banking dependson the size and for of the bank.
6	Relationships	Bank makes relationship with the Customers.	Banking make relationshipwith bank
7	Dissolution	The dissolution of bank is done by the local banking law	When a bank dissolve then the banking activities end.
8	Dependency	Bank is dependent on banker	Banking is depended on the bank
9	Initiation	Banker initiates bank	Bank initiates Banking
10	Entity	As a financial institution it has a separate entity	Banking has no separate entity. It is based on the entity of the bank.

Form and business in which banking companies may engage

(1) In addition to the business of banking, a banking company may engage in any one or more of the following forms of business,namely,-

(a) the borrowing, raising, or taking up of money; the lending or advancing of money either upon or without security; and drawing, making, accepting, discounting, buying, selling, collecting and dealing in bills of exchange, hundies, promissory notes, coupons, drafts, bill of lading, railway receipts, warrants, debentures, certificates, scrips and other instruments, and securities whether transferable or negotiable or not; the granting and issuing of letters of credit, travelers' cheques and circular notes; the buying, selling and dealing in bullion and specie; the buying and selling of foreign exchange including foreign bank notes; the acquiring, holding, issuing on commission, underwriting and dealing in stock, funds, shares, debentures, debenture stock, bonds, obligations, securities and investments of all kinds; the purchasing and selling of bonds, scrips or other forms of securities on behalf of constituents or others; the negotiating of loan and advances; the receiving of all kinds of bonds, scrips or valuables on deposit or for safe custody or otherwise; the providing of safe deposit vaults; the collecting and transmitting of money andsecurities;

(b) acting as agents for any government or local authority or any other person or persons; the carrying on of agency business of any description including the clearing and forwardingof goods, giving of receipts and discharges and otherwise acting as an attorney on behalf of customers, but excluding the business of a 30[Managing Agent or Secretary and Treasurer] of a company;

(c) contracting for public and private loans and negotiating and issuing thesame;

(d) the effecting, insuring, guaranteeing, underwriting, participating in managing and carrying out of any issue, public or private, of State, municipal or other loans or of shares, stock, debentures or debenture stock of any company, corporation or association and the lending of money for the purpose of any suchissue;

(e) carrying on and transacting every kind of guarantee and indemnitybusiness;

(f) managing, selling and realizing any property which may come into the possession of the company in satisfaction or part satisfaction of any of itsclaims;

(g) acquiring and holding and generally dealing with any property or any right, title or interest in any such property which may form the security or part of the security for any loans or advances or which may be connected with any suchsecurity;

(h) undertaking and executingtrusts;

(i) undertaking the administration of estates as executor, trustee orotherwise;

(j) establishing and supporting or aiding in the establishment and support of associations, institutions, funds, trusts, and conveniences calculated to benefit employees or ex-employees of the company or the dependents or connections of such persons; granting pension and allowances and making payments towards insurance; subscribing to or guaranteeing moneys for charitable or benevolent object or for any exhibition or for any public, general or usefulobject;

(k) the acquisition, construction, maintenance and alteration of any building or works necessary or convenient for the purpose of thecompany;

(l) selling, improving, managing, developing, exchanging, leasing, mortgaging, disposing of or turning into account or otherwise dealing with all or any part of the property and rights of the company;

(m) doing all such other things as are incidental or conducive to the promotion or advancement of the business of thecompany;

(o) any other form of business which the Central Government may, by notification in the Official Gazette, specify as a form of business in which it is lawful for a banking company to engage.

(2) No banking company shall engage in any form of business other than those referred to in sub-section(1).

Characteristics/Features of banks

(a) **Dealing in money** – Bank is a financial institution which deals with other people's money i.emoney given bydepositors.
(b) **Individual/Firm/Company** – A bank may be a person, firm or a company. A banking company means a company which is in the business ofbanking.
(c) **Acceptance of Deposit** – A bank accepts money from the people in the form of deposits which are usually repayable on demand or after the expiry of a fixed period. It gives safety to the deposits of its customers. It also acts as a custodian of funds of its customers.
(d) **Giving Advances** – A bank lends out money in the form of loans to those who require it for differentpurposes.
(e) **Payment and Withdrawal** – A bank provides easy payment and withdrawal facility to its customers in the form of cheques and drafts. It also brings bank money in circulation. This money is in the form of cheques, draftsetc.
(f) **Agency and Utility services** – A bank provides various banking facilities to its customers. They include general utility services and agencyservices.
(g) **Profit and Service Orientation** – A bank is a profit seeking institution having service orientedapproach.

(h) **Ever increasing functions** – Banking is an evolutionary concept. There is continuous expansion and diversification as regards the functions, services and activities of abank.

(i) **Connecting Link** – A bank acts as a connecting link between borrowers and lenders of money. Banks collect money from those who have surplus money and give the same to those who are in need ofmoney.

(j) **Banking Business** –A bank's activity should be to do business of banking which should not be subsidiary to any otherbusiness.

(k) **Name Identity** – A bank should always add the word 'bank' to its name to enable people to know that it is a bank and that it is dealing inmoney.

Importance of Banks

Importance of Banking System

Before the banking system originated, banking activities were performed by merchants, money lender, and individuals. This was certainly not the best way to handle currency and people's personal wealth. The system lacked regulations and standardization making general public vulnerable to debauchery and fraud. Therefore, there was an urgent need of organized banking sector that will enable smooth functioning of the economy and safe way to handle money. Additionally, a well-organized banking system provides:

(a) Money for the economic growth of thecountry.

(b) It is the main pillar of the financial sector of thecountry.

(c) It offers a safe place to the individuals or group of individuals to deposit their wealth and keep itsecure.

(d) It offers loans for the personal or developmental purpose to dealers, households, small and largeenterprises.

(e) It provides government money and power to carry out developmentwork.

(f) To equally distribute the money to the citizens of the country and prevent the focus of financial power in the hands of afew.

(g) It helps in implementing monetarypolicies.

(h) It ensures financial stability in thecountry.

(i) It provides financial assistance to the industrial sector of theeconomy.

(j) It helps in generating employmentopportunity.

(k) In India, it plays a major role in providing assistance to the agriculturalsector.

(l) It ensures balanced economic development of thecountry.
(m) It enables capital formation and promotes the habit ofsaving.
(n) And provides finance for trade and industries that is essential to our economic development.

Scope for Banking

(a) Banking activity is useful for trade andIndustry

(b) Distributors & protectors of liquidcapital

(c) Money and precious metals can be keptsafe

(d) Provides credit facility tocustomers

(e) It encourages the habit ofsaving

(f) It meets the financial needs of small scale businesspeople.

(g) It also provides payment settlements through cheque, pay orders, DD, debit and credit cards etc.

(h) Rural banks provide financial support for agriculture, cottage industries and to buy the raw materials etc.

(i) Regional rural banks provide credit facilities to small and marginal farmers, agricultural labourers, artisans and smallentrepreneurs.

Various types of Banking

There are several different types of Banking, all serving different types of needs of the customers. In this eBook, we will learn about various types of Banking and relevance of each type.

(a) BranchBanking:

• Branch banking is engaging in banking activities such as accepting deposits or extending loans at facilities or locations away from a bank's home office orheadquarters.

• Branch banking allows a financial institution to expand its services to an area outside of the home location, functioning as an extension of the home location. It can be a more cost-effective approach because not all the locations are required to offer the same levels of services as the home location, allowing smaller offices to provide key services while larger locations provide additionalservices.

• The advantage of branch banking is that it helps in better management, more inclusion and riskdiversification.

• The disadvantage of branch banking is that it might encourage outside localinfluences.

(b) UnitBanking:

• In unit banking, all the operations are performed from a singlebranch.

• It is a limited way of banking where banks operate only from a single branch or a few branches in the same area taking care of the local population of thatarea.

• The size of the unit banks is small as compared to branchbanking.

• Due to the small size of the Unit Banks, decision making is very fast as the management enjoys more autonomy and discretionary powers at theirdisposal.

• Due to the single unit of the Bank, the risks are notdiversified.

• A customer having an account in a specified branch must undergo all banking activities through thatbranch.

(c) MixedBanking:

• Mixed Banking is the system in which banks undertake activities of commercial and investment bankingtogether.

• It can also be described as the dual functioning of investment banking and commercial banking. These banks give short-term and long-term loans to industrial concerns. Industries don’t have to run to different places for differential financial needs. Mixed Banking thus promotes rapid industrialization.

• Mixed Banking may however pose a grave threat to liquidity of a bank and lead to baddebts.

4. Wholesale Banking:

• Wholesale banking involves banking services for high net-worth clients like corporate, commercial banks, mid-size companiesetc.

• It is provided by banks to organizationslike Corporate Clients, Institutional Customers (such as pension funds & government agencies), International Trade Finance Businesses, Medium Scale Companies, Mortgage Brokers, Real Estate Developers and Investors and services offered to other banks or financialinstitutions.

5. RetailBanking:

• Retail banking means where banking transactions are held directly with customers. The Bank provides all kinds of personal banking services like savings accounts, current accounts, transactional accounts, mortgages, personal loans, debit and credit cards etc. to the customers directly.

• Retail banking is the type of banking that is visible to generalpublic.

6. UniversalBanking:

• Universal banking is a system of banking under which big banks undertake a variety of banking services like commercial banking, insurance, investment banking, merchant banking, mutual fundsetc.

• It involves providing all the above services to the customers under one roof by financial experts who can handle multiple financialproducts.

• This makes the banking operations economical and boosts investor confidence. However, if these kinds of banks fail, it costs huge losses as well as causes a huge dip in consumer confidence.

• The concept of Universal Banking was conceptualized by R.H. Khan inIndia.

7. RelationshipBanking:

• In Relationship Banking, the customer needs are understood by the banks and then appropriate banking services are offered to the customers according to theirneeds.

• This type of Banking helps banks to gather important information about the borrowers which in turn helps them to determine the creditworthiness of thecustomers.

8. VirtualBanking:

• Virtual Banking refers to a banking system wherein the Banking operations are performed online.

• One of the biggest advantages of Virtual Banking is that Banking operations become very cost effective as banks don't need to have physicaloffices.

• Low Banking operations costs are passed on to the customers by the Banks in the form of waiver of fee or offering higher rate of interests onaccounts.

• The Indian markets still have fears instilled in them with respect to virtual banking and they consider branch banking more suitable as they can visit the branch and be assured of their transactions.

9. ChainBanking:

• Chain banking system refers to the type of banking wherein a group of persons come together to own and control three or more independently charteredbanks.

• Despite of common control and ownership, each of the banks can maintain their individual existence andoperations.

• The banks in the chain are assigned different functions so that there is no overlapping of interests and no loss in profits of the respectivebanks.

10. CorrespondentBanking:

• Correspondent Banking is considered the most profitable way of doing business as the Banks do not have any physical presence or any limited permissions in respect to Bankingoperations.

• Correspondent banks thus act as banking agent for a home bank and provide various banking services to customers where otherwise the home bank does notoperate.

• It helps Banks' customers perform banking operations and transactions at any place with ease without the physical presence of their Bank branchesthere.

11. SocialBanking:

• Social Banking refers to the system of Banking wherein Banking Services are oriented towards the public welfare and financial inclusion of the unbanked population, poor and vulnerable section of thesociety.

The Central Bank of India on the directions of the Government of India has taken some commendable initiatives for the financial inclusion of the unbanked populace living in the remotest areas of the country.

12. Narrow Banking:

• The system of narrow banking involves mobilizing the funds towards risk-free investments mostly governmentsecurities.

• It can be considered the opposite of UniversalBanking.

13. Islamic Banking:

• Islamic Banking also known as non-interest Banking is a banking system purely based on the principles of Islam (Sharia Law) and is guided by Islamic law.

• Two fundamental principles of Islamic banking are the sharing of profit and loss and the prohibition of the collection and payment of interest by lenders and investors. Islamic law prohibits collectinginterest.

14. ShadowBanking:

• Shadow Banking is a system of Banking wherein Non-Banking Financial Entities provide banking services like those of commercialBanks.

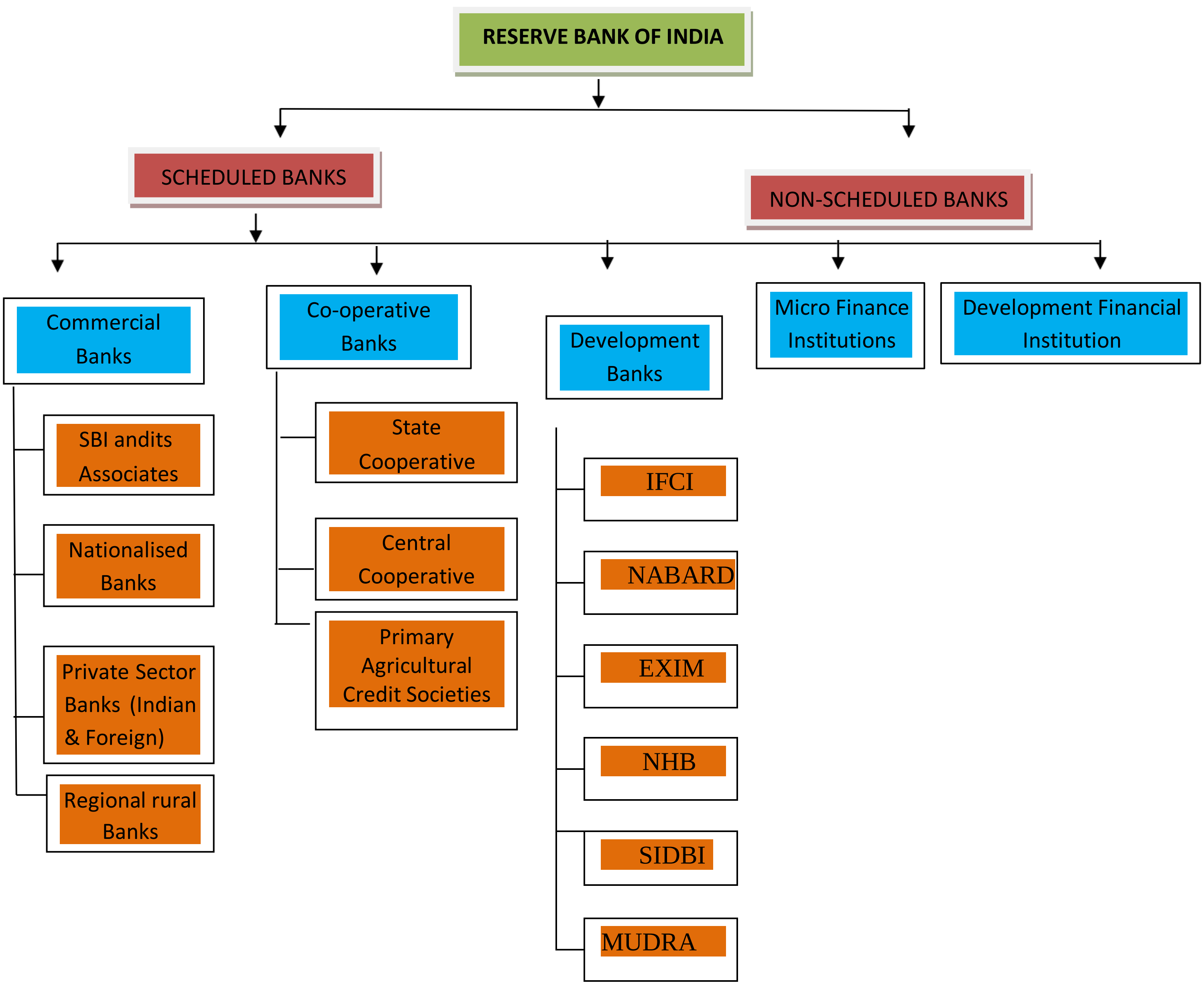
• These Banking Institutions carry out regular banking functions but do so outside the traditional system of regulated depositoryinstitutions.

15. Para-Banking:

• In this system of Banking, Banks perform banking activities different from the regular banking activities (deposit and withdrawal ofmoney).

• Banks under Para-Banking can take up activities by setting upsubsidiaries.

Structure of Indian banking system



Central Banking – Meaning & Definition

A Central bank is an independent national authority that conducts monetary policy, regulates banks and provides financial services including economic research. Its goals are to stabilize the nation's currency, keep unemployment and prevent inflation.

An institution charged with the responsibility of managing the expansion and contraction of the volume of money in the interest of general public welfare. - Prof Kent

One which constitute the apex of the monetary and banking structure of its country - Prof .M.H. DeKock

Establishment

The Reserve Bank of India was established on April 1, 1935 in accordance with the provisions of the **Reserve Bank of India Act, 1934**.The Central Office of the Reserve Bank was initially established in Kolkata but was permanently moved to Mumbai in 1937. The Central Office is where the Governor sits and where policies are formulated. Though originally privately owned, since nationalization in 1949, the Reserve Bank is fully owned by the Government of India.

Preamble

The Preamble of the Reserve Bank of India describes the basic functions of the Reserve Bank as:

"to regulate the issue of Bank notes 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; to have a modern monetary policy framework to meet the challenge of an increasingly complex economy, to maintain price stability while keeping in mind the objective of growth."

As per the RBI Act, the organizational structure of the bank consists of the Central Board and the LocalBoard

THE CENTRAL BOARD-The central board comprises 20 members asfollows:

a. One governor who is the chairman of the central board appointed by the central governor for a period of fiveyears.

b. Four Directors nominated by the central government from each of the four local boards, four deputy governors appointed by the centralgovernment.

c. Four Directors nominated by the central government from each of the four local boards. Ten directors nominated by the central government representing various field from Industry,finance andco-operations.

d. One government official nominated by the central government usually the secretary, Ministry ofFinance.

LOCAL BOARD - The RBI has four local boards in tour regions-the Western, the Eastern the Northern and the southern parts of India. These local boards are headquartered at Mumbai, Kollkata, New Delhi and Chennai respectively. The Central government nominates five members on each local board for tenure of four years. The chairman of each local board is elected from amongmembers.

Functions: To advise the Central Board on local matters and to represent territorial and economic interests of local cooperative and indigenous banks; to perform such other functions as delegated by Central Board from time totime.

Board for Financial Supervision

The Reserve Bank of India performs the supervisory function under the guidance of the Board for Financial Supervision (BFS). The Board was constituted in November 1994 as a committee of the Central Board of Directors of the Reserve Bank of India under the Reserve Bank of India (Board for Financial Supervision) Regulations,1994.

Objective

The primary objective of BFS is to undertake consolidated supervision of the financial sector comprising Scheduled Commercial and Co-operative Banks, All India Financial Institutions, Local Area Banks, Small Finance Banks, Payments Banks, Credit Information Companies, Non-Banking Finance Companies and Primary Dealers.

Constitution

The Board is constituted by co-opting four Directors from the Central Board as Members and is chaired by the Governor. The Deputy Governors of the Reserve Bank are ex-officio members. One Deputy Governor, traditionally, the Deputy Governor in charge of supervision, is nominated as the Vice-Chairman of the Board.

In April 2018, a Sub-committee of the Board for Financial Supervision was constituted, under Para 11 & 12 of the Reserve Bank of India (Board for Financial Supervision) Regulations, 1994. The Sub-committee performs the functions and exercises the powers of supervision and inspection under the Reserve Bank of India Act, 1934 and the Banking Regulation Act, 1949, in relation to Payments Banks, Small Finance Banks, Local Area Banks, small Foreign Banks, select scheduled Urban Co-operative Banks, select Non-Banking Financial Companies and Credit Information Companies. The Sub-committee is chaired by the Deputy Governor in charge of supervision and includes the three Deputy Governors and two Directors of the Central Board asMembers.

BFS Meetings

The Board is required to meet normally once every month. It deliberates on inspection reports, periodic reviews related to banking and non-banking sectors and policy matters arising out of or having relevance to the supervisory functions of the Reserve Bank.

The BFS oversees the functioning of Department of Banking Supervision (DBS), Department of Non-Banking Supervision (DNBS) and Department of Co-operative Bank Supervision (DCBS) and gives directions on regulatory and supervisory issues.

Functions

Some of the initiatives taken by the BFS include:

i. Fine-tuning the supervisory processes adopted by the Bank for regulatedentities;
ii. Introduction of off-site surveillance system to complement the on-site supervision of regulated entities;
iii. Strengthening the statutory audit processes of banks and enlarging the role of auditors in the supervisoryprocess;
iv. Strengthening the internal defences within supervised institutions such as corporate governance, internal control and audit functions, management information and risk control systems, review of housekeeping inbanks;
v. Introduction of supervisory rating system for banks and financialinstitutions;
vi. Supervision of overseas operations of Indian banks, consolidated supervision ofbanks;
vii. Technical assistance programme for cooperativebanks;
viii. Introduction of scheme of Prompt Corrective Action Framework for weakbanks;
ix. Guidance regarding fraud risk management framework inbanks;
x. Introduction of risk based supervision ofbanks;
xi. Introduction of an enforcement framework in respect ofbanks;
xii. Establishment of a credit registry in respect of large borrowers of supervised institutions;and
xiii. Setting up a subsidiary of RBI to take care of the IT requirements, including the cyber security needs of the Reserve Bank and its regulated entities,etc.

Legal Framework

I. Acts administered by Reserve Bank ofIndia

- Reserve Bank of India Act,1934
- Public Debt Act, 1944/Government Securities Act,2006
- Government Securities Regulations,2007
- Banking Regulation Act,1949
- Foreign Exchange Management Act,1999

- Securitization and Reconstruction of Financial Assets and Enforcement of Security Interest Act, 2002 (ChapterII)
- Credit Information Companies(Regulation) Act,2005
- Payment and Settlement Systems Act,2007
  - Payment and Settlement Systems Regulations, 2008 and Amended up to 2011 and BPSS Regulations,2008
  - The Payment and Settlement Systems (Amendment) Act, 2015 - No. 18 of2015
- Factoring Regulation Act,2011

II. Other relevantActs

- Negotiable Instruments Act,1881
- Bankers' Books Evidence Act,1891
- State Bank of India Act,1955
- Companies Act, 1956/ Companies Act,2013
- Securities Contract (Regulation) Act,1956
- State Bank of India Subsidiary Banks) Act,1959
- Deposit Insurance and Credit Guarantee Corporation Act,1961
- Banking Companies (Acquisition and Transfer of Undertakings) Act,1970
- Regional Rural Banks Act,1976
- Banking Companies (Acquisition and Transfer of Undertakings) Act,1980
- National Bank for Agriculture and Rural Development Act,1981
- National Housing Bank Act,1987
- Recovery of Debts Due to Banks and Financial Institutions Act,1993
- Competition Act,2002
- **Indian Coinage Act, 2011** : Governs currency andcoins
- Banking SecrecyAct
- The Industrial Development Bank (Transfer of Undertaking and Repeal) Act,2003
- The Industrial Finance Corporation (Transfer of Undertaking and Repeal) Act,1993

Functions of RBI

Major functions of the RBI are as follows:

I. Traditional Functions Traditional functions are those functions which every central bank of each nation performs all over the world. Basically these functions are in line with the objectives with which the bank is set up. It includes fundamental functions of the Central Bank. They comprise the followingtasks.

1. Issue of Currency Notes: The RBI has the sole right or authority or monopoly of issuing currency notes except one rupee note and coins of smaller denomination. These currency notes are legal tender issued by the RBI. Currently it is in denominations of Rs. 5, 10, 20, 50, 100, 500, and 1,000. The RBI has powers not only to issue and withdraw but even to exchange these currency notes for other denominations. It issues these notes against the security of gold bullion, foreign securities, rupee coins, exchange bills and promissory notes and government of India bonds.

2. Banker to other Banks: The RBI being an apex monitory institution has obligatory powers to guide, help and direct other commercial banks in the country. The RBI can control the volumes of banks reserves and allow other banks to create credit in that proportion. Every commercial bank has to maintain a part of their reserves with its parent's viz. the RBI. Similarly in need or in urgency these banks approach the RBI for fund. Thus it is called as the lender of the lastresort.

3. Banker to the Government: The RBI being the apex monitory body has to work as an agent of the central and state governments. It performs various banking function such as to accept deposits, taxes and make payments on behalf of the government. It works as a representative of the government even at the international level. It government accounts, provides financial advice to the government. It manages government public debts and maintains foreign exchange reserves on behalf of the government. It provides overdraft facility to the government when it faces financialcrunch.

4. Exchange Rate Management: It is an essential function of the RBI. In order to maintain stabilityintheexternalvalueof rupee,ithastopreparedomesticpoliciesinthatdirection.Also

it needs to prepare and implement the foreign exchange rate policy which will help in attaining the exchange rate stability. In order to maintain the exchange rate stability it has to bring demand and supply of the foreign currency (U.S Dollar) close to each other.

5. Credit Control Function: Commercial bank in the country creates credit according to the demand in the economy. But if this credit creation is unchecked or unregulated then it leads the economy into inflationary cycles. On the other credit creation is below the required limit then it harms the growth of the economy. As a central bank of the nation the RBI has to look for growth with price stability. Thus it regulates the credit creation capacity of commercial banks by using various credit controltools.

6. Supervisory Function: The RBI has been endowed with vast powers for supervising the banking system in the country. It has powers to issue license for setting up new banks, to open new branches, to decide minimum reserves, to inspect functioning of commercial banks in India and abroad, and to guide and direct the commercial banks in India. It can have periodical inspections an audit of the commercial banks inIndia.

II. Developmental / Promotional Functions of RBI Along with the routine traditional functions, central banks especially in the developing country like India have to perform numerous functions. These functions are country specific functions and can change according to the requirements of that country. Some of the major development functions of the RBI are given below.

1. Development of the Financial System: The financial system comprises the financial institutions, financial markets and financial instruments. The sound and efficient financial system is a precondition of the rapid economic development of the nation. The RBI has encouraged establishment of main banking and non-banking institutions to cater to the credit requirements of diverse sectors of theeconomy.

2. Development of Agriculture: In an agrarian economy like ours, the RBI has to provide special attention for the credit need of agriculture and allied activities. It has successfully rendered service in this direction by increasing the flow ofcredit to this sector. It has earlier the

Agriculture Refinance and Development Corporation (ARDC) to look after the credit, National Bank for Agriculture and Rural Development (NABARD) and Regional Rural Banks (RRBs).

3. Provision of Industrial Finance: Rapid industrial growth is the key to faster economic development. In this regard, the adequate and timely availability of credit to small, medium and large industry is very significant. In this regard the RBI has always been instrumental in setting up special financial institutions such as ICICI Ltd. IDBI, SIDBI and EXIM BANKetc.

4. Provisions of Training: The RBI has always tried to provide essential training to the staff of the banking industry. The RBI has set up the bankers' training colleges at several places. National Institute of Bank Management i.eNIBM, Bankers Staff College i.eBSC and College of Agriculture Banking i.eCAB are few tomention.

5. Collection of Data: Being the apex monetary authority of the country, the RBI collects process and disseminates statistical data on several topics. It includes interest rate, inflation, savings and investments etc. This data proves to be quite useful for researchers and policymakers.

6. Publication of the Reports: The Reserve Bank has its separate publication division. This division collects and publishes data on several sectors of the economy. The reports and bulletins are regularly published by the RBI. It includes RBI weekly reports, RBI Annual Report, Report on Trend and Progress of Commercial Banks India., etc. This information is made available to the public also at cheaperrates.

7. Promotion of Banking Habits: As an apex organization, the RBI always tries to promote the banking habits in the country. It institutionalizes savings and takes measures for an expansion of the banking network. It has set up many institutions such as the Deposit Insurance Corporation-1962, UTI-1964, IDBI-1964, NABARD- 1982, NHB-1988, etc. These organizations develop and promote banking habits among the people. During economic reforms it has taken many initiatives for encouraging and promoting banking inIndia.

8. Promotion of Export through Refinance: The RBI always tries to encourage the facilities for providing finance for foreign trade especially exports from India. The Export-Import Bankof

India (EXIM Bank India) and the Export Credit Guarantee Corporation of India (ECGC) are supported by refinancing their lending for export purpose.

III. Supervisory Functions of RBI RBI has authority to regulate and administer the entire banking and financial system. Some of its supervisory functions are givenbelow.

1. Granting license to banks: The RBI grants license to banks for carrying its business. License is also given for opening extension counters, new branches, even to close down existingbranches.

2. Bank Inspection: The RBI grants license to banks working as per the directives and in a prudent manner without undue risk. In addition to this it can ask for periodical information from banks on various components of assets andliabilities.

3. Control over NBFIs: The Non-Bank Financial Institutions are not influenced by the working of a monitory policy. However RBI has a right to issue directives to the NBFIs from time to time regarding their functioning. Through periodic inspection, it can control theNBFIs.

4. Implementation of the Deposit Insurance Scheme: The RBI has set up the Deposit Insurance Guarantee Corporation in order to protect the deposits of small depositors. All bank deposits below Rs. One lakh are insured with this corporation. The RBI work to implement the Deposit Insurance Scheme in case of a bankfailure.

Role of RBI in Credit Control (Tools and techniques of credit control / weapons of RBI for credit control)

Probably the most important of all the functions performed by a central bank are that of controlling the credit operations of commercial banks. In modern times, bank credit has become the most important source of money in the country, relegating coins and currency notes to a minor position. Moreover, it is possible for commercial banks to expand credit and thus intensify inflationary pressure or contract credit and thus contribute to a deflationary situation. It is, thus, of great importance that there should be some authority which will control the credit creation by commercial banks. As controller of credit, the central bank attempts to influence and control the volume of Bank credit and also to stabilize business condition in thecountry.

I) General / Quantitative Credit Control Methods:- In India, the legal framework of RBI's control over the credit structure has been provided Under Reserve Bank of India Act, 1934 and the Banking Regulation Act, 1949. Quantitative credit controls are used to maintain proper quantity of credit of money supply in market. Some of the important general credit control methods are:-

1. Bank Rate Policy:- Bank rate is the rate at which the Central bank lends money to the commercial banks for their liquidity requirements. Bank rate is also called discount rate. In other words bank rate is the rate at which the central bank rediscounts eligible papers (like approved securities, bills of exchange, commercial papers etc) held by commercial banks. Bank rate is important because it is the pace setter to other market rates of interest. Bank rates have been changed several times by RBI to control inflation andrecession.

2. Open market operations:- It refers to buying and selling of government securities in open market in order to expand or contract the amount of money in the banking system. This techniqueis superior to bank rate policy. Purchases inject money into the banking system while sale of securities do the opposite. During last two decades the RBI has been undertaking switch operations. These involve the purchase of one loan against the sale of another or, vice-versa. This policy aims at preventing unrestricted increase inliquidity.

3. Cash Reserve Ratio (CRR) The Cash Reserve Ratio (CRR) is an effective instrument of credit control. Under the RBl Act of, l934 every commercial bank has to keep certain minimum cash reserves with RBI. The RBI is empowered to vary the CRR between 3% and 15%. A high CRR reduces the cash for lending and a low CRR increases the cash for lending. The CRR has been brought down from 15% in 1991 to 7.5% in May 2001. It further reduced to 5.5% in December 2001. It stood at 5% on January 2009. In January 2010, RBI increased the CRR from 5% to 5.75%. It further increased in April 2010 to 6% as inflationary pressures had started building up in the economy. As of March 2011, CRR is 6% and now it is 4%w.e.f.09/02/2013.

4. Statutory Liquidity Ratio (SLR) Under SLR, the government has imposed an obligation on the banks to; maintain a certain ratio to its total deposits with RBI in the form of liquid assets like cash, gold and other securities. The RBI has power to fix SLR in the range of 25%and 40%

between 1990 and 1992 SLR was as high as 38.5%. Narasimham Committee did not favour maintenance of high SLR.

5. Repo and Reverse Repo Rates In determining interest rate trends, the repo and reverse repo rates are becoming important. Repo means Sale and Repurchase Agreement. Repo is a swap deal involving the immediate Sale of Securities and simultaneous purchase of those securities at a future date, at a predetermined price. Repo rate helps commercial banks to acquire funds from RBI by selling securities and also agreeing to repurchase at a laterdate.

Reverse repo rate is the rate that banks get from RBI for parking their short term excess funds with RBI. Repo and reverse repo operations are used by RBI in its Liquidity Adjustment Facility. RBI contracts credit by increasing the repo and reverse repo rates and by decreasing them it expands credit

II) Selective / Qualitative Credit Control Methods:- Under Selective Credit Control, credit is provided to selected borrowers for selected purpose, depending upon the use to which the control tries to regulate the quality of credit - the direction towards the credit flows. The Selective Controlsare:-

1. Ceiling on Credit: The Ceiling on level of credit restricts the lending capacity of a bank to grant advances against certain controlledsecurities.

2. Margin Requirements: A loan is sanctioned against Collateral Security. Margin means that proportion of the value of security against which loan is not given. Margin against a particular security is reduced or increased in order to encourage or to discourage the flow of credit to a particular sector. It varies from 20% to 80%. For agricultural commodities it is as high as 75%. Higher the margin lesser will be the loansanctioned.

3. Discriminatory Interest Rate (DIR) :Through DIR, RBI makes credit flow to certain priority or weaker sectors by charging concessional rates of interest. RBI issues supplementary instructions regarding granting of additional credit against sensitive commodities, issue of guarantees, making advances etc.

4. Directives: The RBI issues directives to banks regarding advances. Directives are regarding the purpose for which loans may or may not begiven.

5. Direct Action: It is too severe and is therefore rarely followed. It may involve refusal by RBI to rediscount bills or cancellation of license, if the bank has failed to comply with the directives ofRBI.

6. Moral Suasion: Under Moral Suasion, RBI issues periodical letters to bank to exercise control over credit in general or advances against particular commodities. Periodic discussions are held with authorities of commercial banks in thisrespect.

Offices

- Has **27 regional offices, most of them in state capitals and 04Sub-offices**.

Training Establishments

Have six training establishments

- Three, namely, RBI Academy, College of Agricultural Banking and Reserve Bank of India Staff College are part of the ReserveBank.
- Others are autonomous, such as, National Institute for Bank Management, Indira Gandhi Institute for Development Research (IGIDR), Institute for Development and Research in Banking Technology(IDRBT)

Subsidiaries

Fullyowned:

Deposit Insurance and Credit Guarantee Corporation of India (DICGC),

Bharatiya Reserve Bank Note Mudran Private Limited (BRBNMPL),

Reserve Bank Information Technology Private Limited (ReBIT),

Indian Financial Technology and Allied Services (IFTAS)

Departments in RBI

To carry out its functions/operations smoothly and efficiently, the Reserve Bank of India has the following departments.

1. **Banking Department:** The Banking Department is responsible for rendering the bank's services as a banker to the Government and to the banks.It consists of four sub-divisions: (i) Public Accounts Department; (ii) Public Debt Department; (iii) Deposit Accounts Department; and (iv) SecuritiesDepartment.

There are 14 branches of the Banking Department, each headed by a Joint/Deputy Manager.

2. **Issue Department:** The Issue Department is concerned with the proper and efficient management of the note issue. For the conduct of monetary transactions, the country has been divided into 14 circles of issue, each having an Office of Issue — the branch of the Issue Department. Each branch of the Issue Department consists of: (i) theGeneral Department and (ii) the Cash Department controlled by the currency officer. The General Department deals with resource operations, i.e., arrangement of supply of notes and coins from the presses and Government Mints. The Cash Department deals with the cash transactions.

3. **Department of Currency Management:** This department is concerned with the forecasting of the long-term requirements of the currency, indenting and allocation of currency notes to various branches of the Issue Department taking into account the demand pattern, storage facilities, etc. It is headed by the Chief Officer.

4. **Department of Expenditure and Budgetary Control:** This department is concerned with the preparation of the bank's budget and monitoring of the expenditure of the different units. It is headed by the FinancialController

5. **Department of Government and Bank Accounts:** This department is concerned with the maintenanceandsupervisionofthebank'saccountsintheIssueandtheBankingDepartments

and the compilation of weekly statements of affairs and the Annual Profits & Loss Account and Balance Sheet. It is headed by the Chief Accountant.

6. Exchange Control Department: The Exchange Control department is responsible for controlling foreign exchange transactions and maintaining exchange ratestability.

7. Department of Banking Operations and Development: This Department was entrusted with the responsibility of the supervision, control and development of the commercial bank system in the country. Till July 1982, it was also concerned with the Lead Bank Scheme and bank credit to the prioritysectors.

8. Industrial Credit Department: The Industrial Finance Department is basically concerned with the administration of the Credit Guarantee Scheme for small scale industries or as agent of the Government of India, with the operational and organizational aspects of the State Financial Corporation's (SFCs), work connected with the Industrial Development Bank of India (IDBI), data collection about financing of small-scale industries and other relevantproblems.

It also deals with the operation and administration of the Credit Authorization Scheme.

9. Agricultural Credit Department: This department is mainly responsible for building up of a sound cooperative credit structure in rural financing, supplementing the financial resources of state co-operative banks, providing financial assistance to State Governments to strengthen the co-operative structure, advising Central and State Governments on agricultural and rural credit, formulating policies for taking over of PACs for financing by commercial banks, coordinating the long-term credit activities of State Land Development Banks,etc.
The department alsokeeps liaison with the Agricultural Refinance and Development Corporation, the Agricultural Finance Corporation, SCBs and LDBs.

With the establishment of the NABARD now, all functions of the Agricultural Credit Department have been transferred to this new institution, except for the supervision and control over the operations of the primary (urban) co-operative banks. The responsibility of supervision and control of PCBs are now shifted to the Department of Banking Operations andDevelopment.

10. **Rural Planning and Credit Department:** This department was established in 1982. It is basically concerned with issues like District Credit Plans, Lead Bank Scheme, provision of expert guidance/assistance and processing and sanction of general lines of credit for short-term advances to the NABARD, special studies for promoting IRDP, and for framing the Reserve Bank's policy on ruraldevelopment.

11. **Department of Non-BankingCompanies:**

This department administers and controls as well as regulates deposits of non-banking financial companies.

12. **Credit PlanningCell:**

The Credit Planning and Banking Development Cell have been constituted for the formulation and monitoring of credit policies as well as the developmental aspects of commercial banking.

It chalks out macro-level monetary budgets of the country.

13. **Department of Economic Analysis andPolicy:**

This department conducts economic research and reviews financial and banking conditions in the country. The Economic Department comprises five units: (i) the Internal Finance Unit; (ii) International Finance Unit; (iii) Prices, Production and General Unit; (iv) Analysis of National Economic Parameters Unit; and (v) General Unit.

The Economic Department prepares the Bank's Annual Report, the Report on Trend and Progress of Banking in India, the Report on Currency and Finance, and the Reserve Bank of India Bulletins. It also undertakes ad hoc studies on emerging aspects of banking and other importantissues.

14. **Department of Statistical Analysis and ComputerServices:**

Its main function involves the generation, collection, processing and compilation of statistical data relating to the banking and financial sectors from the operational as well as research point of view.

15. LegalDepartment:

It tenders legal advice on various matters referred to it by the Bank.

16. InspectionDepartment:

It carries out internal inspections of the offices and departments of the bank.

17. Department of Administration andPersonnel:

It looks after the general administration and personnel policy, such as recruitment, training, placements, promotions, transfers, discipline, appeals, service conditions, wage structure, etc.

18. PremisesDepartment:

It is mainly concerned with the construction of buildings for the Bank’s offices, training institutions and staff quarters.

19. Management ServicesDepartment:

It is basically concerned with organisational analysis, systems research and development, work procedure studies and codification, manpower planning, costing studies, etc.

20. Reserve Bank of India ServiceBoard:

Its functions involve conducting of examinations/interviews for the selection and promotion of staff in the Reserve Bank.

21. Central Records and DocumentationCentre:

It is meant for the preservation of non-current records of the Bank. It provides arrangement for the scientific preservation of records, retrieval service to the enquirer departments, tools of reference such as catalogues, indices, etc.

22. Secretary'sDepartment:

It attends to the secretarial work connected with the meetings of the Central Board and its committee and of the Administrators of the RBI Employee's Provident Fund and RBI Employees' Co-operative Guarantee Fund.

23. TrainingEstablishments:

The Reserve Bank has set-up three prominent training institutions for imparting training in different areas of banking.

These are:

(i) the Banker's Training College,Bombay

(ii) the College of Agricultural Banking,Pune

(iii) the Reserve Bank Staff College,Madras

There are also Zonal Training Centres situated in Bombay, Calcutta, Madras and New Delhi for conducting induction, functional and short-term preparatory courses for the clerical staff.

Scheduled Banks

Scheduled Banks as the name suggest are the banks, which are accounted in the Second Schedule of the Reserve Bank of India (RBI) Act, 1934. To qualify as a scheduled bank, the bank should conform to the following conditions:

Scheduled Banks are those banks which are listed in 2nd schedule of RBI Act 1934. In other words, the banks which follow the guidelines of the 2nd schedule of RBI Act 1934. Scheduled banks can take loans from RBI at Repo rateor bank rate. Some major criteria to be scheduled banks are as follows.

- Banks must deposit 500 crores to RBI as a paid-upcapital.
- Banks must open 25% of its branches in ruralareas.

- At least 40% of loan must be distributed to priority sectors like SC/ST, PH, Housing, Educationetc.

The bank requires satisfying the central bank that its affairs are not carried out in a way that causes harm to the interest of thedepositors.

The bank needs to be a corporation rather than a sole-proprietorship or partnership firm.

Scheduled banks enjoy certain rights such as:

- Right to receive refinance facility from the apexbank
- Entitled for currency chestfacility.
- Right to become members of clearinghouse

However, they are required to fulfill certain obligations like maintenance of an average daily balance of CRR (Cash Reserve Ratio) with the central bank at the rates specified by it. Add to that these banks need to submit returns at regular intervals, to the central bank subject to the rules of Reserve Bank of India Act, 1934 and Banking Regulation Act, 1949.

The Scheduled Commercial Banks are Nationalized Banks, Private Banks, Developmental Banks, Regional Rural Banks, Foreign Banks and CooperativeBanks.

Non Scheduled Banks

Non-Scheduled Bank refers to the banks which are not listed in the Second Schedule of Reserve Bank of India. **Banks** with a reserve capital of less than 5 lakh rupees qualify as **non-scheduled banks**. Unlike **scheduled banks**, they are not entitled to borrow from the RBI for normal **banking** purposes, except, in emergency or “abnormalcircumstances."

In finer terms, the banks which do not comply with the provisions specified by the central bank, within the meaning of the Reserve Bank of India Act, 1934, or as per specific functions, etc. or as per the judgement of the RBI, are not able to serve and protect the depositor’s interest, are known as non-scheduledbanks.

Non-Scheduled Banks are also required to maintain the cash reserve requirement, not with the RBI, but with them. These are local area banks. Jammu & Kashmir Bank is an **example** of a **non-scheduled** commercialbank.

Characteristics of non-scheduled commercial banks

1. They are not included in the second schedule of RBI act 1934 and as such they cannot avail any loan facilities withRBI
2. They get licenseto conduct as per Banking Regulation act1949
3. They can be started by individuals, trusts etc apart fromcorporate
4. They can function only in three districts and not morethat
5. All local area banks are non-scheduledbanks

Difference between Scheduled and Non- Scheduled Banks

Basis for comparison	Scheduled Banks	Non- Scheduled banks
Meaning	Scheduled banks is a banking corporation whose minimum paid up capital is Rs. 25 lakhs and does not harm the interest of the depositors	Non-scheduled banks are the banks which do not comply with the rules specified by the Reserve Bank of India, or say the banks which do not come under the category of scheduled banks.
Second Schedule	Listed in the second schedule	Not-listed in the second schedule.
Cash Reserve Ratio	Maintained with RBI.	Maintained with them.
Borrowing	Scheduled banks areallowed to borrow money from RBI for regular bankingpurposes.	Non-Scheduled banks arenot allowed to borrow money from RBI for regularbanking

		purposes
Returns	To be submitted periodically.	No such provision of submitting periodicreturns.
Members of clearing house	It can become a member of clearing house.	It cannot become member of clearing house.

What is Commercial Bank?

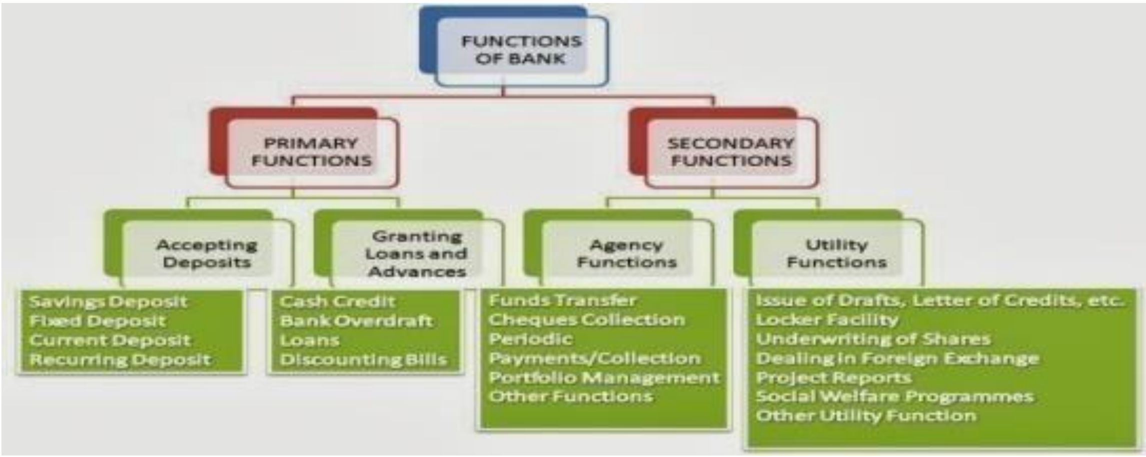
A commercial bank is a kind of financial institution which carries all the operations related to deposit and withdrawal of money for the general public, providing loans for investment, etc. These banks are profit-making institutions and do business only to make a profit.

The two primary characteristics of a commercial bank are lending and borrowing. The bank receives the deposits and gives money to various projects to earn interest (profit). The rate of interest that a bank offers to the depositors is known as the borrowing rate, while the rate at which banks lends the money is called the lendingrate.

Commercial banks are formed under the Schedule II of the RBI Act, 1934 which satisfies the following criteria:

- Minimum Paid-up capital of 5lakhs
- Must be a corporation orsociety
- No activities must adversely affect the depositor’sinterest.

Functions of Bank



There are two types of functions of banks:

1. Primary functions – being primary are also called bankingfunctions.
2. SecondaryFunctions

Both the types of functions of bank are explained below in detail:

Primary Functions of Bank

All banks have to perform two major primary functions namely:

1. Accepting ofdeposits
2. Granting of loans andadvances

Accepting of Deposits

A very basic yet important function of all the commercial banks is mobilizing public funds, providing safe custody of savings and interest on the savings to depositors. Bank accepts different types of deposits from the public such as:

1. **Saving Deposits:** encourages saving habits among the public. It is suitable for salary and wage earners. The rate of interest is low. There is no restriction on the numberand

amount of withdrawals. The account for saving deposits can be opened in a single name or in joint names. The depositors just need to maintain minimum balance which varies across different banks. Also, Bank provides ATM cum debit card, cheque book, and Internet bankingfacility.

2. **Fixed Deposits:** Also known as Term Deposits. Money is deposited for a fixed tenure. No withdrawal money during this period allowed. In case depositors withdraw before maturity, banks levy a penalty for premature withdrawal. As a lump-sum amount is paid at one time for a specific period, the rate of interest is high but varies with the period of deposit.
3. **Current Deposits**: are opened by businessmen. The account holders get overdraft facility on this account. These deposits act as a short term loan to meet urgent needs. Bank charges a high-interest rate along with the charges for overdraft facility in order to maintain a reserve for unknown demands for theoverdraft.
4. **Recurring Deposits:** A certain sum of money is deposited in the bank at a regular interval. Money can be withdrawn only after the expiry of a certain period. A higher rate of interest is paid on recurring deposits as it provides a benefit of compounded rate of interest and enables depositors to collect a big sum of money. This type of account is operated by salaried persons and pettytraders.

Granting of Loans & Advances

The deposits accepted from the public are utilized by the banks to advance loans to the businesses and individuals to meet their uncertainties. Bank charges a higher rate of interest on loans and advances than what it pays on deposits. The difference between the lending interest rate and interest rate for deposits is bankprofit.

Bank offers the following types of Loans and Advances:

1. **Bank Overdraft**: This facility is for current account holders. It allows holders to withdraw money anytime more than available in bank balance but up to the provided limit. An overdraft facility is granted against collateral security. The interest for overdraft is paid only on the borrowed amount for the period for which the loan istaken.

2. **Cash Credits:** a short term loan facility up to a specific limit fixed in advance. Banks allow the customer to take a loan against a mortgage of certain property (tangible assets and / guarantees). Cash credit is given to any type of account holders and also to those who do not have an account with a bank. Interest is charged on the amount withdrawn in excess of the limit. Through cash credit, a larger amount of loan is sanctioned than that of overdraft for a longerperiod.
3. **Loans:** Banks lend money to the customer for short term or medium periods of say 1 to 5 years against tangible assets**.** Nowadays, banks do lend money for the long term. The borrower repays the money either in a lump-sum amount or in the form of installments spread over a pre-decided time period. Bank charges interest on the actual amount of loan sanctioned, whether withdrawn or not. The interest rate is lower than overdrafts and cash creditsfacilities.
4. **Discounting the bill of exchange:** It is a type of short term loan, where the seller discounts the bill from the bank for some fees. The bank advances money by discounting or purchasing the bills of exchange. It pays the bill amount to the drawer(seller) on behalf of the drawee (buyer) by deducting usual discount charges. On maturity, the bank presents the bill to the drawee or acceptor to collect the billamount.

Secondary Functions of Bank

Like Primary Functions of Bank, the secondary functions are also classified into two parts:

1. Agencyfunctions
2. UtilityFunctions

Agency Functions of Bank

Banks are the agents for its customers; hence it has to perform various agency functions as mentioned below:

Transfer of Funds: Transferring of funds from one branch/place to another.

Periodic Collections: collecting dividend, salary, pension, and similar periodic collections on the clients'behalf.

Periodic Payments: making periodic payments of rents, electricity bills, etc on behalf of the client.

Collection of Cheques: Like collecting money from the bills of exchanges, the bank collects the money of the cheques through the clearing section of its customers.

Portfolio Management: banks manage the portfolio of their clients. It undertakes the activity to purchase and sell the shares and debentures of the clients and debits or credits the account.

Other Agency Functions: under this bank act as a representative of its clients for other institutions. It acts as an executor, trustee, administrators, advisers etc. of the client.

Utility Functions of Bank

- Issuing letters of credit, traveller’s cheque,etc.
- Undertaking safe custody of valuables, important documents and securities by providing safe deposit vaults orlockers.
- Providing customers with facilities of foreign exchangedealings
- Underwriting of shares anddebentures
- Dealing in foreignexchanges
- Social Welfareprogrammes
- Projectreports
- Standing guarantee on behalf of its customers,etc.

Types of Commercial Banks

Public Banks: Banks in which 50% of the capital is provided by central Government 15% by the State Government and 35% by the sponsoring commercial bank. State Bank of India

- Bank ofIndia
- Punjab NationalBank
- AllahabadBank
- Central Bank ofIndia
- IndianBank
- Bank ofBaroda
- UCO Bank

- CanaraBank

Private Banks: Bank in which the major share capital is subscribed by private investors. Private Sector banks are those banks where major stakes (51%) is of private entities. The shares of private sector banks are also listed in the stockexchange.

Few big names of private banks are below.

- HDFCBank
- ICICIBank
- AxisBank
- YesBank
- Kotak MahindraBank
- IndusIndBank
- IDFCBank

Foreign Banks: Banks which are incorporated outside India. The banks which are incorporated or have their headquarters in a foreign country and open their branches in India as per RBI Act 1934 is known as foreign banks.

Some examples of the foreign bank are:

- CityBank
- HSBCBank
- Standard CharteredBank

Co-operative banks: Co-operative banks are banks incorporated in the legal form of cooperatives. Any cooperative society has to obtain a license from the Reserve Bank of India before starting banking business and has to follow the guidelines set and issued by the Reserve Bank of India. Currently, there are 68 co-operatives banks in India. There are three types of co-operatives banks with different functions:

Primary Credit Societies: Primary Credit Societies are formed at the village or town levelwithborrowerandnon-borrowermembersresidinginonelocality.Theoperationsofeach society are restricted to a small area so that the members know each other and are able to watch over the activities of all members to prevent frauds.

Central Co-operative Banks: Central co-operative banks operate at the district level having some of the primary credit societies belonging to the same district as their members. These banks provide loans to their members (i.e., primary credit societies) and function as a link between the primary credit societies and state co-operative banks.

State Co-operative Banks: These are the highest level co-operative banks in all the states of the country. They mobilize funds and help in its proper channelization among various sectors. The money reaches the individual borrowers from the state co-operative banks through the central co- operative banks and the primary creditsocieties.

Regional rural Banks: The regional rural banks are banks set up to increase the flow of credit to smaller borrowers in the rural areas. These banks were established on realizing that the benefits of the co-operative banking system were not reaching all the farmers in rural areas. Currently, there are 196 regional rural banks in India. Regional rural banks perform the following two functions:

1. Granting of loans and advances to small and marginal farmers, agricultural workers, co-operative societies including agricultural marketing societies and primary agricultural credit societies for agricultural purposes or agricultural operations or relatedpurposes.

2. Granting of loans and advances to artisans small entrepreneurs engaged in trade, commerce or industry or other productiveactivities.

Development Banks: Development Banks are banks that provide financial assistance to business that requires medium and long-term capital for purchase of machinery and equipment, for using latest technology, or for expansion and modernization. A development bank is a multipurpose institution which shares entrepreneurial risk, changes its approach in tune with industrial climate and encourages new industrial projects to bring about speedier economic growth. These banks also undertake other development measures like subscribing to the shares and debentures issued by companies, in case of under subscription of the issue by the public. There are three important national level development banks. They are;

Industrial Development Bank of India (IDBI): The IDBI was established on July 1, 1964 under an Act of Parliament. It was set up as the central co-ordinating agency, leader of development banks and principal financing institution for industrial finance in the country. Originally, IDBI was a wholly owned subsidiary of RBI. But it was delinked from RBI w.e.f. Feb. 16, 1976. IDBI is an apex institution to co-ordinate, supplement and integrate the activities of all existing specialised financial institutions. It is a refinancing and re-discounting institution operating in the capital market to refinance term loans and export credits. It is in charge of conducting techno-economic studies. It was expected to fulfil the needs of rapid industrialisation. The IDBI is empowered to finance all types of concerns engaged or to be engaged in the manufacture or processing of goods, mining, transport, generation and distribution of power etc., both in the public and privatesectors.

Industrial Finance Corporation of India (IFCI): The IFCI is the first Development Financial Institution in India. It is a pioneer in development banking in India. It was established in 1948 under an Act of Parliament. The main objective of IFCI is to render financial assistance to large scale industrial units, particularly at a time when the ordinary banks are not forth coming to assist these concerns. Its activities include project financing, financial services, merchant banking and investment. Till 1993, IFCI continued to be Developmental Financial Institution. After 1993, it was changed from a statutory corporation to a company under the Indian Companies Act, 1956 and was named as IFCI Ltd with effect from October1999.

Industrial Credit and Investment Corporation of India (ICICI) ICICI was set up in 1955 as a public limited company. It was to be a private sector development bank in so far as there was no participation by the Government in its share capital. It is a diversified long term financial institution and provides a comprehensive range of financial products and services including project and equipment financing, underwriting and direct subscription to capital issues, leasing, deferred credit, trusteeship and custodial services, advisory services and business consultancy. The main objective of the ICICI was to meet the needs of the industry for long term funds in the private sector.

Apart from this the Industrial Reconstruction Corporation of India (IRCI) established in 1971 with the main objective of revival and rehabilitation of viable sick units and was converted in to the Industrial Reconstruction Bank of India (IRBI) in 1985 with more powers Development banks have been established at the state level too. At present in India, 18 State Financial Corporation's (SFCs) and 26 State Industrial investment/Development Corporations (SIDCs) are functioning to look over the development banking in respective areas/states.

Specialized Banks In India, there are some specialized banks, which cater to the requirements and provide overall support for setting up business in specific areas of activity. They engage themselves in some specific area or activity and thus, are called specialized banks. There are three important types of specialized banks with differentfunctions:

Export Import Bank of India (EXIM Bank): The Export-Import (EXIM) Bank of India is the principal financial institution in India for coordinating the working of institutions engaged in financing export and import trade. It is a statutory corporation wholly owned by the Government of India. It was established on January 1, 1982 for the purpose of financing, facilitating and promoting foreign trade of India. This specialized bank grants loans to exporters and importers and also provides information about the international market. It alsogives guidance about the opportunities for export or import, the risks involved in it and the competition to be faced, etc. The main functions of the EXIM Bank are as follows: (i) Financing of exports and imports of goods and services, not only of India but also of the third world countries; (ii) Financing of exports and imports of machinery and equipment on lease basis; (iii) Financing of joint ventures in foreign countries; (iv) Providing loans to Indian parties to enable them to contribute to the share capital of joint ventures in foreign countries; (v) to undertake limited merchant banking functions such as underwriting of stocks, shares, bonds or debentures of Indian companies engaged in export or import; and (vi) To provide technical, administrative and financial assistance to parties in connection with export and import.

Small Industries Development Bank of India This specialized bank grant loan to those who want to establish a small-scale business unit or industry. Small Industries Development Bank of India (SIDBI) was established in October 1989 and commenced its operation from April 1990withitsHeadOfficeatLucknowasadevelopmentbank,exclusivelyforthesmallscale

Industries. It is a central government undertaking. The prime aim of SIDBI is to promote and develop small industries by providing them the valuable factor of production finance. Many institutions and commercial banks supply finance, both long-term and short-term, to small entrepreneurs. SIDBI coordinates the work of all of them. Functions of Small Industries Development Bank of India (SIDBI):

(i) Initiates steps for technology adoption, technology exchange, transfer and upgradation and modernization of existing units.

(ii) SIDBI participates in the equity type of loans on soft terms, term loan, working capital both in rupee and foreign currencies, venture capital support, and different forms of resource support to banks and other institutions.

(iv) SIDBI facilitates timely flow of credit for both term loans and working capital to SSI in collaboration with commercial banks.

(iv) SIDBI enlarges marketing capabilities of the products of SSIs in both domestic and international markets.

(v) SIDBI directly discounts and rediscounts bills with a view to encourage bills culture and helping the SSI units to realize their sale proceeds of capital goods / equipment's and components etc.

(v) (vi) SIDBI promotes employment oriented industries especially in semi-urban areas to create more employment opportunities so that rural-urban migration of people can bechecked.

National Bank for Agricultural and Rural Development It was established on 12 July 1982 by a special act by the parliament. This specialized bank is a central or apex institution for financing agricultural and rural sectors. It can provide credit, both short-term and long-term, through regional rural banks. It provides financial assistance, especially, to co-operative credit,in the field of agriculture, small-scale industries, cottage and village industries handicrafts and allied economic activities in rural areas .its important functionsare:

a) Takes measures towards institution building for improving absorptive capacity of the credit delivery system, including monitoring, formulation of rehabilitation schemes, restructuring of credit institutions, training of personnel,etc.

b) Co-ordinates the rural financing activities of all institutions engaged in developmental work at the field level and maintains liaison with Government of India, State Governments, Reserve Bank of India (RBI) and other national level institutions concerned with policyformulation

c) Undertakes monitoring and evaluation of projects refinanced byit.

d) NABARD refinances the financial institutions which finances the ruralsector.

e) The institutions which help the rural economy, NABARD helpsdevelop.

f) NABARD also keeps a check on its clientinstitutes.

g) It regulates the institution which provides financial help to the ruraleconomy.

h) It provides training facilities to the institutions working the field of ruralupliftment.

i) It regulates the cooperative banks and the RRB Indian Bank-like financial institutions In India, there are some Bank-like financial institutions that provide financial services. There are two types of such institution that are important to the development onIndia:

Microfinance Institutions Microfinance Institutions are Bank-like financial institutions that providing financial services, such as microcredit, micro savings or micro insurance to poor people. In addition, they also perform the following important functions:

1. provide financing facilities, with or without collateral security, in cash or in kind, for such terms and subject to such conditions as may be prescribed, to poor persons for all types of economic activities including housing, but excluding business in foreign exchange transactions

2. To buy, sell and supply on credit to poor persons industrial and agricultural inputs, livestock, machinery and industrial raw materials

3. To provide professional advice to poor persons regarding investments in small business and such cottage industries as may beprescribed;

Development financial institutions (DFIs) DFIs are specialized financial institutions the Government established to promote investments in the manufacturing and agricultural sectors.Theirfunctionsinclude:1.Extendingfinancialassistanceintheformofmedium-and long-term loans, participating in equity capital, underwriting and wherever relevant, acting as issuing house for public shares issues and providing guarantees for loans 2. Specialize in medium- and long-term financing in addition to supplying financial services not normally provided by commercial banks and finance companies 3. In addition, they help in identifying new projects, participate in their promotion, and where appropriate, provide ancillary financial, technical and managerialadvice

Local Area Banks (LAB)

- Introduced in India in the year1996
- These are organized by the privatesector
- Earning profit is the main objective of Local AreaBanks
- Local Area Banks are registered under companies Act,1956
- At present, there are only 4 Local Area Banks all which are located in SouthIndia
- Examples: (i) Coastal Local Area BankLimited

  (ii) Capital Local Area BankLimited

  (iii) Krishna Bhima Samruddhi Local Area BankLimited

  (iv) Subhadra Local Area Bank Limited

Small Finance Banks

As the name suggests this type of bank looks after the micro industries, small farmers, and the unorganized sector of the society by providing those loans and financial assistance. These banks are governed by the central bank of the country.

Given below is the list of the Small Finance Banks in our country:

AU Small Finance Bank
Equitas Small Finance Bank
Jana Small Finance Bank
Northeast Small Finance Bank
Capital Small Finance Bank
Fincare Small Finance Bank
Suryoday Small Finance Bank
Ujjivan Small Finance Bank

Payments Banks

A newly introduced form of banking, the payments bank has been conceptualized by the Reserve Bank of India. People with an account in the payments bank can only deposit an amount of up to Rs.1, 00,000/- and cannot apply for loans or credit cards under this account.

Options for online banking, mobile banking, the issue of ATM, and debit card can be done through payments banks. Given below is a list of the few payments bank in our country:

- Airtel PaymentsBank
- India Post PaymentsBank
- FinoPaymentsBank
- Jio PaymentsBank
- Paytm PaymentsBank
- NSDL PaymentsBank

Distinguish between Central and Commercial Bank

S.No.	**Point of Distinction**	**Central Bank**	**Commercial Banking**
1	**Formation**	Central Bank is the sole banking Institution which is established through ordinance or special law of the Government.	Commercial Bank is formed on the basis of Banking Company Laws.
2	**Ownership**	Central Bank is established under Government ownership	Commercial Bank is established under both govt. and private Ownership.
3	**Purpose**	To earn profit is not the main purpose of central bank. Its main purpose is to control credit system and money market.	The main purpose of commercial bank is to earn profit. Recovery of loan is the main stay for generation of profit.
4	**Number**	In a country there is only one Central Bank	In a country there may be more number of commercial banks.
5	**Control**	Central bank is conducted exclusively under Government control	Commercial Bank is conducted under central bank's control.
6	**Government Influence**	Government has direct influence on Central Bank	Government has indirect influence On

			Commercial Bank through Central Bank.
7	**Currency Market**	Central Bank organizes, controls and administers currency market.	Commercial Banks are the members of the currency market.
8	**Competition**	Central Bank does not compete with other banks.	Commercial Bank has to face to face lot of competition
9	**Representative**	Central Bank represents the country or state	Commercial Bank represents the Customers
10	**Foreign Branch**	Central Bank has no branch abroad	Commercial Bank may have many Branches abroad
11	**Note issue**	Note issue is the primary function of central bank	Commercial Bank cannot issue notes
12	**Credit control**	Central Bank controls credit.	Commercial Bank assists central bank In controlling credit
13	**Clearing House**	Central Bank acts as a clearing house for settlement of inter-bank transactions.	Commercial banks are the members of the clearing house. They settle transactions through clearing house
14	**Lender of**	In case of any crisis, central bank Last resort lends commercial bank as a last resort.	Commercial Bank gets assistance from central bank in case of need
15	**Nature of work**	Central bank is not engaged in general banking activities i.e. to receive deposits, to lend, to create loan etc	Commercial bank is engaged in receiving deposits, paying money, creating loan etc.
16	**Foreign Exchange**	Central Bank controls foreign exchange	Commercial bank helps central bank in controlling foreign exchange
17	**Investments**	Central bank does not Make any investment for profitability purpose.	Commercial bank makes investments in various sectors for the purpose of profitability

18	**Refinance Facility**	Central bank refinances commercial bank against first class securities, bill of exchange	Commercial bank takes refinance facility from the central bank.
19	**Development work**	Central Bank formulates policy on development Work	Commercial bank participates in the development program Initiated by the central bank.

Role of Commercial Banks as a Financial Intermediary

Commercial banks play several roles as financial intermediaries.

First, they *repackage the deposits* received from investors into loans that are provided to firms. In this way, small deposits by individual investors can be consolidated and channeled in the form of large loans to firms. Individual investors would have difficulty achieving this by themselves because they do not have adequate information about the firms that need funds.

Second, commercial banks employ credit analysts who have the ability to *assess the creditworthiness* of firms that wish to borrow funds. Investors who deposit funds in commercial banks are not normally capable of performing this task and would prefer that the bank play this role.

Third, commercial banks have so much money to lend that they can *diversify loans* across several borrowers. In this way, the commercial banks increase their ability to absorb individual defaulted loans by reducing the risk that a substantial portion of the loan portfolio will default. As the lenders, they accept the risk of default. Many individual investors would not be able to absorb the loss of their own deposited funds, so they prefer to let the bank serve in this capacity. Even if a commercial bank were to close because of an excessive amount of defaulted loans, the deposits of each investor are insured up to $100,000 by the FDIC. Thus the commercial bank is a means by which funds can be channeled from small investors to firms without the investors having to play the role of lender.

Fourth, some commercial banks have recently been authorized (since the late 1980s) to *serve as financial intermediaries* by placing the securities that are issued by firms. Such banks may facilitate the flow of funds to firms by finding investors who are willing to purchase the debt securities issued by the firms. Thus they enable firms to obtain borrowed funds even though they do not provide the funds themselves.

Recent developments in Banking Sector

Core Banking

Core banking is normally defined as the business conducted by a banking institution with its retail and small business customers. Many banks treat the retail customers as their core banking customers and have a separate line of business to manage small business. Larger business is handled by the corporate banking division of the institution. Core banking basically is depositing and lending of money.

Now a days, most banks use core banking applications to support their operations where 'CORE' stands for "Centralized Online Real-time Environment'. This basically means that all the bank's branches access applications from centralized data centres.

It means that the deposits made are reflected immediately on the servers of banks and the customer can withdraw the deposited money from any of the branches of bank throughout the world. These applications now also have the capability to address the needs of corporate customers providing a comprehensive banking solution.

Normal core banking functions will include deposit accounts, loans, mortgages and payments. Bank makes these services available across multiple channels like ATMS. Internet banking and branches.

Features of Core Banking

1. Customer relationship management features including a 360 degree customer view.
2. The ability to originate new products and customers.
3. Banking analytics including risk analysis, profitability analysis and provisions for capital reserve allocation and collateral management.
4. Banking finance including general ledger and reporting.
5. Banking channels such as teller systems, side counter applications, mobile banking and online banking solutions.
6. Best practice workflow process.
7.Content management facilities
8.Governance and compliance capabilities such as internal controls management and auditing.
9. Security control and audit capabilities
10. Core banking solutions to help maximize growth, increase productivity and mitigate risk.

Advantages of Core Banking

1. Limited professional manpower to be utilized more effectively.
2. Customer can have anywhere, more convenient and easier banking.
3. ATM, Interest Banking, Mobile Banking, Payment Gateways etc.
4. More strong and economical way of management information system.

5. Reduction in branch manpower.

6. Additional manpower can be available for marketing, recovery and personalized banking.

7. Instant information available for decision support

8. Quick and accurate implementation of policies

9. Improved recovery process causing reduction on recovery costs, NPA provisions

10. Innovative, redefined or improved processes i.e Inter Branch Reconciliation causing reduction in manpower at Head office.

11.Reduction in software maintenance at branch and Head office.

12. Centralized printing and backup resulting in reduction in capital and revenue expenditure on printing and backup devices and media at branches

13. Electronic Transactions with other financial institutions.

14. Increased speed in working resulting in more business opportunities and reduction in penalities and legal expenses.

Disadvantages of core banking:

1. Excessive reliance on era
2. Any failure in pc structures can cause whole community to head down
3. If records aren't included nicely and if right care isn't always taken, hackers can advantage get admission to the data.

Elements of Core Banking Include:

- Making and servicing loans.
- Opening new accounts.
- Processing cash deposits and withdrawals.
- Processing payments and cheques.
- Calculating interest.
- Customer relationship management (CRM) activities.
- Managing customer accounts.
- Establishing criteria for minimum balances, interest rates, number of withdrawals allowed and so on.
- Establishing interest rates.
- Maintaining records for all the bank's transactions.

E-Banking

- The term online became popular in the late '80s and referred to the use of a terminal, keyboard and TV (or monitor) to access the banking system using a phone line.
- Stanford federal credit union was the first who offer online internet banking services to all of its members in 1994.
- Later on snapped up by other banks like Well Fargo, Chase Manhattan and Security First Bank.
- Opening up of economy in 1991 marked the entry of foreign banks. They brought new technology with them.
- Banking products became more and more competitive. Need for differentiation of products and services was felt.
- The ICICI Bank kicked off online banking in 1996. Currently 78% of its customer base is registered for online banking.
- 1996 to 1998 marked the adoption phase, while usage increased only in 1999, owing to lower ISP online charges, increased PC penetration and a tech-friendly atmosphere. Ex: Answering routine queries, Bill payment service, Electronic Fund transfer (ETF), Electronic Clearing System (ECS), Credit card customers, Railway Pass, Investing through internet banking, Recharging, Shopping, etc..

Electronic banking has many names like e banking, virtual banking, online banking, or internet banking. It is simply the use of electronic and telecommunications network for delivering various banking products and services. Through e-banking, a customer can access his account and conduct many transactions using his computer or mobile phone.

Types of e banking

Banks offer various types of services through electronic banking platforms. These are of three types:

Level 1 – This is the basic level of service that banks offer through their websites. Through this service, the bank offers information about its products and services to customers. Further, some banks may receive and reply to queries through e-mail too.

Level 2 – In this level, banks allow their customers to submit instructions or applications for different services, check their account balance, etc. However, banks do not permit their customers to do any fund-based transactions on their accounts.

Level 3 – In the third level, banks allow their customers to operate their accounts for funds transfer, bill payments, and purchase and redeem securities, etc.

Most traditional banks offer e-banking services as an additional method of providing service. Further, many new banks deliver banking services primarily through the internet or other electronic delivery channels. Also, some banks are 'internet only' banks without any physical branch anywhere in the country.Therefore, banking websites are of two types:

1. **Informational Websites** – These websites offer general information about the bank and its products and services to customers.
2. **Transactional Websites** – These websites allow customers to conduct transactions on the bank's website. Further, these transactions can range from a simple retail account balance inquiry to a large business-to-business funds transfer. The following table lists some common retail and wholesale e-banking services offered by banks and financial institutions:

Common E-Banking Services

Retail Services	Wholesale Services
Account management	Account management
Bill payment	Cash management
New account opening	Small business loan applications, approvals, or advances
Consumer wire transfers	Commercial wire transfers
Investment / Brokerage services	Business-to-business payments
Loan application and approval	Employee benefits / pension administration
Account aggregation	

Importance of e-banking

We will look at the importance of electronic banking for banks, individual customers, and businesses separately.

Banks

1. Lesser transaction costs – electronic transactions are the cheapest modes of transaction
2. A reduced margin for human error – since the information is relayed electronically, there is no room for human error
3. Lesser paperwork – digital records reduce paperwork and make the process easier to handle. Also, it is environment-friendly.
4. Reduced fixed costs – A lesser need for branches which translates into a lower fixed cost.
5. More loyal customers – since e-banking services are customer-friendly, banks experience higher loyalty from its customers.

Customers

1. Convenience – a customer can access his account and transact from anywhere 24x7x365.
2. Lower cost per transaction – since the customer does not have to visit the branch for every transaction, it saves him both time and money.
3. No geographical barriers – In traditional banking systems, geographical distances could hamper certain banking transactions. However, with e-banking, geographical barriers are reduced.

Businesses

1. Account reviews – Business owners and designated staff members can access the accounts quickly using an online banking interface. This allows them to review the account activity and also ensure the smooth functioning of the account.
2. Better productivity – Electronic banking improves productivity. It allows the automation of regular monthly payments and a host of other features to enhance the productivity of the business.
3. Lower costs – Usually, costs in banking relationships are based on the resources utilized. If a certain business requires more assistance with wire transfers, deposits, etc., then the bank charges it higher fees. With online banking, these expenses are minimized.
4. Lesser errors – Electronic banking helps reduce errors in regular banking transactions. Bad handwriting, mistaken information, etc. can cause errors which can prove costly. Also, easy review of the account activity enhances the accuracy of financial transactions.
5. Reduced fraud – Electronic banking provides a digital footprint for all employees who have the right to modify banking activities. Therefore, the business has better visibility into its transactions making it difficult for any fraudsters to play mischief.

Popular services covered under E-Banking

1. Automated TellerMachines,
2. CreditCards,
3. DebitCards,
4. SmartCards,

5. Automated TellerMachines,

6. CreditCards,

7. DebitCards,

8. SmartCards,

9. Electronic Funds Transfer (EFT)System,

10. MobileBanking,

11. InternetBanking,

12. Tele-banking

13. Homebanking

14. Dematfacility

15. Cheques Truncation PaymentSystem

1. **Automated Teller Machine**: An ATM is a computerized Tele-communication device which provides the customers the access to financial transactions in public places without human inters- mention. It enables the customers to perform several banking operations such as withdrawals of cash, request of mini-statement etc. The advantages of ATMare:

(a) ATM provides 24 hours service: ATMs provide service round the clock. The customer can withdraw cash up to a certain a limit during any time of the day ornight.

(b) ATM gives convenience to bank's customers: ATMs provide convenience to the customers. Now-a-days, ATMs are located at convenient places, such as at the air ports, railway stations, etc. and not necessarily at the Bank'spremises.

(c) ATM reduces the workload of bank's staff.: ATMs reduce the work pressure on bank's staff and avoids queues in bankpremises.

(d) ATM provides service without any error: ATMs provide service without error. The customer can obtain exact amount. There is no human error as far as ATMs areconcerned.

(e) ATM is very beneficial for travellers: ATMs are of great help to travellers. They need not carry large amount of cash withthem.

(f) ATM may give customers new currency notes: The customer also gets brand new currency notes from ATMs. In other words, customers do not get soiled notes fromATMs.

(g) ATM provides privacy in banking transactions: Most of all, ATMs provide privacy in banking transactions of thecustomer.

2. **Electronic Transfer of Funds:** This is an electronic debit or credit of customers account. Bank customers can buy goods and services without caring cash by using credit or debit cards. There cards are issued to the customers by the bankers. This system works on a pin (personal identification number). The Customer swipes the card by using the card reader device to make the transactions. The development of electronic banking and internet banking helped the customers to utilize theirservices.

3. **Tele-Banking:** It is increasingly used in these days. It is a delivery channel for marketing, banking services. A customer can do non-cash business related banking over the phoneanywhere and at any time. Automatic voice recorders are used for rendering tale-bankingservices.

4. **Mobile Banking**: It is another important service provided by the banks recently. The customers can utilize it with the help of a cell phone. The bank will install particular software and provide a password to enable a customer to utilize thisservice.

5. **Home Banking**: It is another important innovation took place in Indian banking sector. The customers can perform a no. of transactions from their home or office. They can checkthe

balance and transfer the funds with the help of a telephone. But it is not that popularly utilized in our country.

6. **Internet Banking**: It is the recent trend in the Indian banking sector. It is the result of development took place in information technology. Internet banking means any user or customer with personal computer and browser can get connected to his banks website and perform any service possible through electronic delivery channel. There is no human operator present in the remote location to respond. Allthe services listed in the menu of bank website will beavailable.

7. **Demat Banking**: It is nothing but de-materialization. This is a recent extant in the Indian banking sector. The customer who wants to invest in stock market or in share and stock needs to maintain this account with the commercial banks. The customer needs to pay certain annual charges to the banks for maintaining this type ofaccounts.

8. **Credit Cards** A credit card is a small plastic card issued to users as a system of payment. It allows its holder to buy goods and services based on the holder's promise to pay for these goods and services. The issuer of the card creates a revolving account and grants a line of credit to the consumer (or the user) from which the user can borrow money for payment to a merchant or as a cash advance to the user. A credit card is different from a charge card: a charge card requires the balance to be paid in full each month. In contrast, credit cards allow the consumers a continuing balance of debt, subject to interest being charged. A credit card also differs from a cash card, which can be used like currency by the owner of the card. Most credit cards are issued by banks or creditunions.

9. **Debit Card** A debit card (also known as a bank card or check card) is a plastic card that provides the cardholder electronic access to his or her bank account/s at a financial institution. Some cards have a stored value against which a payment is made, while most relay a message to the cardholder's bank to withdraw funds from a designated account in favour of the payee's designated bank account. The card can be used as an alternative payment method to cash when making purchases. In some cases, the cards are designed exclusively for use on the Internet, and so there is no physical card. In many countries the use of debit cards has become so widespread that their volume of use has overtaken or entirely replaced the check and, in some instances, cash transactions.Likecreditcards,debitcardsareusedwidelyfortelephoneandInternetpurchases.

However, unlike credit cards, the funds paid using a debit card are transferred immediately from the bearer's bank account, instead of having the bearer pay back the money at a later date.

10. **Cheques Truncation Payment system (CTPS**) Truncation is the process of stopping the flow of the physical cheque issued by a drawer to the drawee branch. The physical instrument will be truncated at some point en- route to the drawee branch and an electronic image of the cheque would be sent to the drawee branch along with the relevant information like the MICR fields, date of presentation, presenting banks etc. Thus with the implementation of cheque truncation, the need to move the physical instruments across branches would not be required, except in exceptional circumstances. This would effectively reduce the time required for payment of cheques, the associated cost of transit and delay in processing, etc., thus speeding up the process of collection or realization of thecheques.

Role of Commercial Banks in Economic Development

1. CapitalFormation

Banks play an important role in capital formation, which is essential for the economic development of a country. They mobilize the small savings of the people scattered over a wide area through their network of branches all over the country and make it available for productive purposes.

Now-a-days, banks offer very attractive schemes to attract the people to save their money with them and bring the savings mobilized to the organized money market. If the banks do not perform this function, savings either remains idle or used in creating assets, which are low in scale of planpriorities.

2. Creation ofCredit

Banks create credit for the purpose of providing more funds for development projects. Credit creation leads to increased production, employment, sales and prices and thereby they cause faster economic development.

3. Channelizing the Funds to ProductiveInvestment

Banks invest the savings mobilized by them for productive purposes. Capital formation is not the only function of commercial banks. Pooled savings should be distributed to various sectors of the economy with a view to increase the productivity of the nation. Then only it can be said to have performed an important role in the economic development of the nation.

Commercial Banks aid the economic development of the nation through the capital formed by them. In India, loan lending operation of commercial banks subject to the control of the RBI. So our banks cannot lend loan, as they like.

4. Fuller Utilization of Resources

Savings pooled by banks are utilized to a greater extent for development purposes of various regions in the country. It ensures fuller utilization of resources.

5. Encouraging Right Type ofIndustries

The banks help in the development of the right type of industries by extending loan to right type of persons. In this way, they help not only for industrialization of the country but also for the economic development of the country. They grant loans and advances to manufacturers whose products are in great demand. The manufacturers in turn increase their products by introducing new methods of production and assist in raising the national income of the country.

6. Bank RatePolicy

Economists are of the view that by changing the bank rates, changes can be made in the money supply of a country. In our country, the RBI regulates the rate of interest to be paid by banks for the deposits accepted by them and also the rate of interest to be charged by them on the loans granted by them.

7. Bank Monetize Debt

Commercial banks transform the loan to be repaid after a certain period into cash, which can be immediately used for business activities. Manufacturers and wholesale traders cannot increase their sales without selling goods on credit basis. But credit sales may lead to locking up of capital. As a result, production may also be reduced. As banks are lending money by discounting bills of exchange, business concerns are able to carry out the economic activities without anyinterruption.

8. Finance toGovernment

Government is acting as the promoter of industries in underdeveloped countries for which finance is needed for it. Banks provide long-term credit to Government by investing their funds in Government securities and short-term finance by purchasing TreasuryBills.

9. Bankers as Employers

After the nationalization of big banks, banking industry has grown to a great extent. Bank's branches are opened in almost all the villages, which leads to the creation of new employment opportunities. Banks are also improving people for occupying various posts in their office.

10. Banks areEntrepreneurs

In recent days, banks have assumed the role of developing entrepreneurship particularly in developing countries like India. Developing of entrepreneurship is a complex process. It includes the formation of project ideas, identification of specific projects suitable to local conditions, inducing new entrepreneurs to take up these well-formulated projects and provision of counseling services like technical and managerialguidance.

Banks provide 100% credit for worthwhile projects, which is also technically feasible and economically viable. Thus commercial banks help for the development of entrepreneurship in the country.

Further, under Internet banking, the following services are available in India:

1. **Bill payment** – Every bank has a tie-up with different utility companies, service providers, insurance companies, etc. across the country. The banks use these tie-ups to offer online payment of bills (electricity, telephone, mobile phone, etc.). Also, most banks charge a nominal one-time registration fee for this service. Further, the customer can create a standing instruction to pay recurring bills automatically every month.
2. **Funds transfer** – A customer can transfer funds from his account to another with the same bank or even a different bank, anywhere in India. He needs to log in to his account, specify the payee's name, account number, his bank, and branch along with the transfer amount. The transfer is effected within a day or so.
3. **Investing** – Through electronic banking, a customer can open a fixed deposit with the bank online through funds transfer. Further, if a customer has a demat account and a linked bank account and trading account, he can buy or sell shares online too. Additionally, some banks allow customers to purchase and redeem mutual fund units from their online platforms as well.
4. **Shopping** – With an e-banking service, a customer can purchase goods or services online and also pay for them using his account. Shopping at his fingertips.

Impact of Technology in Banking Sector:

Positive impact of technology on banking sector:-

- The biggest revolution came in banks is Digitization.
- Banking process is faster than before and more reliable. Maintenance and retrieval of documents and records have become much faster and easier.
- Computerized banking also improves the core banking system. With CBS (core banking system) all branches have access to common centralized data and are interconnected.
- With the innovation of MICR cheque processing system, the processing of cheques becomes more faster and efficient h than before.
- USSD (Unstructured supplementary service data) was launched by Government, so people with no internet-connectivity too can access their bank accounts without visiting the branch.
- With increasing internet reach, Internet Banking was developed and now offered by almost every bank. Through this, every transaction details and inquiries can be performed online without visiting the bank.
- It offered more transparency in transactions.
- The scope of frauds in banks is being minimized through the use of passwords, double authentication in online banking.
- Technology also leads to competition among the banks which eventually provides better services to people.
- With introduction of mobile banking, one can access their bank from anywhere-anytime. Everything is one quick tap away.
- To facilitate better services, Banks have introduced Automated Banking Services Solution like Cash Deposit Machine, Cheque Deposit Machine, Passbook Printing Machine through these service have become easier.

Negative impact of technology on banking sector:-

- The biggest negative impact of technology is loss of Jobs as automation has replaced number of jobs in banking sector.
- Through technology comes the threat of Cyber Attack, a loophole in the system, millions of data can be lost in the blink of an eye.
- These technologies consumes less time, it also sometimes makes people careless-which causes loss of personal details as happened last year in 2016,many debit cards details of big banks were compromised.

PAYMENT BANKS

What are Payment Banks?

- A payments bank (Airtel Payments Bank, India Post Payments Bank, etc.) is like any other bank, but operating on a smaller or restricted scale.
- Credit risk is not involved with the Payments Bank. It can carry out most banking operations but cannot advance loans or issue credit cards.
- It can accept demand deposits only i.e. savings and current accounts, not time deposits.
- The Payment Banks cannot set up subsidiaries to undertake non-banking financial services activities.
- A committee headed by Dr. NachiketMor recommended setting up of 'Payments Bank' to cater to the lower income groups and small businesses.

- **Benefits:** Expansion of rural banking, access to diversified services, social & financial inclusion are some of the benefits.
- **Challenges:** Lack of customer awareness, lack of incentives for agents, lack of infrastructure, technological issues are some of the challenges.

Note:

- There are two kinds of banking licences that are granted by the Reserve Bank of India - universal bank licence and differentiated bank licence.
- Payments bank comes under a differentiated bank licence since it cannot offer all the services that a commercial bank offers. In particular, a payments bank cannot lend.
- It can take deposits upto ₹1 lakh per account and it can issue debit cards but not credit cards.
- Commercial banks in India like State Bank of India or ICICI Bank, do not have any such restrictions.

Objectives

- The objectives of setting up of a payments bank is to further financial inclusion by providing small savings accounts and payments/remittance services to migrant labour workforce, low income households, small businesses, other unorganised sector entities and other users.

Scope of Activities

- Acceptance of demand deposits initially restricted to holding a maximum balance of Rs 100,000 per individual customer.
- Issuance of ATM/debit cards.
- They cannot issue credit cards.
- They are not allowed to give loans.
- Payments and remittance services through various channels.
- Distribution of non-risk sharing simple financial products like mutual fund units and insurance products, etc.
- They are only allowed to invest the money received from customers' deposits into government securities.
- They cannot accept NRI deposits.
- A payments bank account holder would be able to deposit and withdraw money through any ATM or other service providers.
- Payments licensees would be granted to mobile firms, supermarket chains and others to cater to individuals and small businesses.

Eligible Promoters

- Existing non-bank Pre-paid Payment Instrument (PPI) issuers;
- Other entities such as
    - individuals/professionals;
    - Non-Banking Finance Companies (NBFCs),
    - Corporate Business Correspondents (BCs), mobile telephone companies,

  - Supermarket chains, companies, real sector cooperatives; that are owned and controlled by residents; and
  - Public sector entities may apply to set up payments banks.
- A promoter/promoter group can have a joint venture with an existing scheduled commercial bank to set up a payments bank.
- Scheduled commercial banks can take equity stake in a payments bank to the extent permitted under the Banking Regulation Act, 1949.

Regulation

- The Payments Bank will be registered as a public limited company under the Companies Act, 2013. It is governed by the provisions of the Banking Regulation Act, 1949; RBI Act, 1934; Foreign Exchange Management Act, 1999, Payment and Settlement Systems Act, 2007, other relevant Statutes and Directives.
- They need to maintain a Cash Reserve Ratio (CRR).
- Required to invest a minimum 75% of its "demand deposit balances" in Statutory Liquidity Ratio (SLR) eligible Government securities/treasury bills with maturity up to one year.
- Need to hold maximum 25% in current and time/fixed deposits with other scheduled commercial banks for operational purposes and liquidity management.

Other Important Provisions

- **Capital requirement:** The minimum paid-up capital for payments bank is Rs 100 crore.
- **Promoter's contribution:** Minimum initial contribution to the paid-up equity capital shall at least be 40% for the first five years from the commencement of its business.
- **Foreign shareholding:** The foreign shareholding in the payments bank would be as per the Foreign Direct Investment (FDI) policy for private sector banks as amended from time to time.

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SCHOOL OF MANAGEMENT STUDIES

UNIT – 2 – Banking and Insurance Management – SBAA7001

UNIT 2 BANKING PRODUCTS AND SERVICES

Products/Services offered by banks – Deposit products – Credit Products – Payment and Custodial Services; Credit appraisal Techniques – Approach to lending; Credit Management – credit monitoring – NPA management – Priority Sector Lending – Factoring – Ancillary Services; Remittances, safe Deposit lockers etc; Payment and Collection of Cheque – duties and responsibilities of paying and collectingbanker.

Products/ Services offered by banks - Introduction

A product is a packaged offer made by a bank. It has a structure, a target audience and a price tag. It can be quantified easily.

It becomes a service, when you utilize it. This is about the actual delivery - the people and processes that deliver, customer satisfaction, customer retention etc. It is the qualitative aspect.

Broad Classification of Products Offered by Banks

The different products in a bank can be broadly classified into:

(a) RetailBanking.
(b) Trade Finance.
(c) TreasuryOperations.

Retail Banking and Trade finance operations are conducted at the branch level while the wholesale banking operations, which cover treasury operations, are at the head office or a designated branch.

(a) Retail Banking:

- Deposits
- Loans, Cash Credit andOverdraft

- Negotiating for Loans andadvances
- Remittances
- Book-Keeping (maintaining all accountingrecords)
- Receiving all kinds of bonds valuable for safekeeping

(b) Trade Finance:

- Issuing and confirming of letter of credit.
- Drawing, accepting, discounting, buying, selling, collecting of bills of exchange, promissory notes, drafts, bill of lading and othersecurities.

(c)Treasury Operations:

- Buying and selling of bullion, Foreignexchange.
- Acquiring, holding, underwriting and dealing in shares, debentures,etc.
- Purchasing and selling of bonds and securities on behalf ofconstituents.

The banks can also act as an agent of the Government or local authority. They insure, guarantee, underwrite, participate in managing and carrying out issue of shares, debentures, etc.

Apart from the above-mentioned functions of the bank, the bank provides a whole lot of other services like investment counseling for individuals, short-term funds management and portfolio management for individuals and companies. It undertakes the inward and outward remittances with reference to foreign exchange and collection of varied types for the Government.

	Products	Services
Deposits	• Savings accounts. • Current accounts. • Time deposits. • Salary accounts. • Compensation for service time (CTS). • Accounts in other currencies. • Bank certificates. • Variable interest deposits.	• Opening accounts. • Cash withdrawals and deposits. • Transfers between own accounts and to third parties. • Payment of services or credit cards. • Balance enquiry. • Automatic charging for payments • Buying/selling foreign currencies • Prepaid cell phones top-up • Issuing checks
Loans	• Personal loans (consumer). • Car loans. • Mortgage loans. • Study loans. • Loans for foreign trade. • Financial leasing. • Factoring.	• Loan application and payment. • Simulation of repayments. • Consultation of payment schedule. • Loan repayments.
Cards	• Credit cards. • Debit cards (linked to a deposit account). • Credit cards linked to retailers (gas stations, airlines, etc.). • Prepaid cards.	• Card application and delivery. • Simulation of repayments • Transfers of debt and to line repayments. • Cash withdrawal. • Card account statement enquiry. • Points collection and exchange. • Consultation of payment schedule.
Other	• Indirect credits: guarantees, finance letters, letters of credit, unused facilities… • Investments (asset management, mutual funds, stock market brokerage). • Insurance (life, life savings, cancer, unemployment, card protection, payment protection, hospitalization income, others).	• Money management. • Purchase/Sale of stocks. • Purchase / Sale of mutual fund shares. • Purchase / Sale of insurance.

Common Banking Products Available

Some of common available banking products are explained below:

1) Credit Card: Credit Card is “postpaid” or “pay later” card that draws from a credit line-money made available by the card issuer (bank) and gives one a grace period to pay. If the amount is not paid full by the end of the period, one is charged interest. A credit card is nothing but a very small card containing a means of identification, such as a signature and a small photo. It authorizes the holder to change goods or services to his account, on which he is billed. The bank receives the bills from the merchants and pays on behalf of the card holder. These bills are assembled in the bank and the amount is paid to the bank by the card holder totally or by installments. The bank charges the customer a small amount for these services. The card holder need not have to carry money/cash with him when he travels or goes for purchasing. Creditcards have found wide spread acceptance in the ‘metros’ and big cities. Credit cards are joining popularity for online payments. The major players in the Credit Card market are the foreign banks and some big public sector banks like SBI and Bank of Baroda. India at present has about 10 million credit cards incirculation.

2) **Debit Cards:** Debit Card is a “prepaid” or “pay now” card with some stored value. Debit Cards quickly debit or subtract money from one’s savings account, or if one were taking out cash. Every time a person uses the card, the merchant who in turn can get the money transferred to his account from the bank of the buyers, by debiting an exact amount of purchase from the card. To get a debit card along with a Personal Identification Number (PIN). When he makes a purchase, he enters this number on the shop’s PIN pad. When the card is swiped through the electronic terminal, it dials the acquiring bank system — either Master Card or Visathat validates the PIN and finds out from the issuing bank whether to accept or decline the transaction. The customer never overspread because the amount spent is debited immediately from the customer’s account. So, for the debit card to work, one must already have the money in the account to cover the transaction. There is no grace period for a debit card purchase. Some debit cards have monthly or per transaction fees. Debit Card holder need not carry a bulky checkbook or large sums of cash when he/she goes at for shopping. This is a fast and easy wayof payment one can get debit card facility as debit cards use one’s own money at the time of sale, so they are often easier than credit cards to obtain. The major limitation of Debit Card is that currently only some shops in urban areas accepts it. Also, a person can’t operate it in case the telephone lines aredown.

3) **Automated Teller Machine:** The introduction of ATM’s has given the customers the facility of round the clock banking. The ATM’s are used by banks for making the customers dealing easier. ATM card is a device that allows customer who has an ATM card to perform routine banking transaction at any time without interacting with human teller. It provides exchange services. This service helps the customer to withdraw money even when the banks are closed. This can be done by inserting the card in the ATM and entering the Personal Identification Number and secretPassword.

ATM's are currently becoming popular in India that enables the customer to withdraw their money 24 hours a day and 365 days. It provides the customers with the ability to withdraw or deposit funds, check account balances, transfer funds and check statement information. The advantages of ATM's are many. It increases existing business and generates new business. It allows the customers.

- To transfer money to and fromaccounts.
- To view accountinformation.
- To ordercash.
- To receivecash.

Advantages of ATM's:

- **To theCustomers**

- ATM's provide 24 hrs., 7 days and 365 days a yearservice.
- Service is quick andefficient
- Privacy intransaction
- Wider flexibility in place and time ofwithdrawals.
- The transaction is completely secure — you need to key in Personal Identification Number (Unique number for everycustomer).

To Banks

- Alternative to extend bankinghours.
- Crowding at bank counters considerablyreduced.
- Alternative to new branches and to reduce operatingexpenses.
- Relieves bank employees to focus an more analytical and innovativework.
- Increased marketpenetration.

ATM's can be installed anywhere like Airports, Railway Stations, Petrol Pumps, Big Business arcades, markets, etc. Hence, it gives easy access to the customers, for obtaining cash.

The ATM services provided first by the foreign banks like Citibank, Grind lays bank and now by many private and public sector banks in India like ICICI Bank, HDFC Bank, SBI, UTI Bank etc. The ICICI has launched ATM Services to its customers in all the Metropolitan Cities in India. By the end of 1990 Indian Private Banks and public sector banks have come up with their own ATM Network in the form of “SWADHAN”. Over the past year upto 44 banks in Mumbai, Vashi and Thane, have became a part of “SWADHAN” a system of shared payments networks, introduced by the Indian Bank Association(IBA).

4) **E-Cheques:** The e-cheques consists five primary facts. They are the consumers, the merchant, consumer’s bank the merchant’s bank and the e-mint and the clearing process. This cheaqing system uses the network services to issue and process payment that emulates real world chequeing. The payer issues digital cheques to the payee ant the entire transactions are done through internet. Electronic version of cheques are issued, received and processed. A typical electronic cheque transaction takes place in the followingmanner:

- The customer accesses the merchant server and the merchant server presents its goods to the customer.
- The consumer selects the goods and purchases them by sending an e-cheque to the merchant.
- The merchant validates the e-cheque with its bank for paymentauthorization.
- The merchant electronically forwards the e-cheque to itsbank.
- The merchant’s bank forwards the e-cheque to the clearing house forcashing.
- The clearing house jointly works with the consumer’s bank clears the cheque and transfers the money to the merchant’sbanks.
- The merchant’s bank updates the merchant’saccount.
- The consumer’s bank updates the consumer’s account with the withdrawalinformation.

The e-chequeing is a great boon to big corporate as well as small retailers. Most major banks accept e-cheques. Thus this system offers secure means of collecting payments, transferring value and managing cashflows.

5) Electronic Funds Transfer (EFT): Many modern banks have computerized their cheque handling process with computer networks and other electronic equipment's. These banks are dispensing with the use of paper cheques. The system called electronic fund transfer(EFT) automatically transfers money from one account to another. This system facilitates speedier transfer of funds electronically from any branch to any other branch. In this system the sender and the receiver of funds may be located in different cities and may even bank with different banks. Funds transfer within the same city is also permitted. The scheme has been in operation since February 7, 1996, in India. The other important type of facility in the EFT system is automated clearing houses. These are the computer centers that handle the bills meant for deposits and the bills meant for payment. In big companies pay is not disbursed by issued cheques or issuing cash. The payment office directs the computer to credit an employee's account with the person'spay.

6) Telebanking: Telebanking refers to banking on phone services.. a customer can access information about his/her account through a telephone call and by giving the coded Personal Identification Number (PIN) to the bank. Telebanking is extensively user friendly and effective innature.

- To get a particular work done through the bank, the users may leave his instructions in the form of message withbank.
- Facility to stop payment on request. One can easily know about the chequestatus.
- Information on the current interestrates.
- Information with regard to foreign exchangerates.
- Request for a DD or payorder.
- DeMat Account related services.
- And other similarservices.

7) Mobile Banking: A new revolution in the realm of e-banking is the emergence of mobile banking. On-line banking is now moving to the mobile world, giving everybody with a mobile phone access to real-time banking services, regardless of their location. But there is much more to mobile banking from just on-lie banking. It provides a new way to pick up information and interact with the banks to carry out the relevant banking business. The potential ofmobile banking is limitless and is expected to be a big success. Booking and paying for travel and even tickets is also expected to be a growth area. According to this system, customer can access account details on mobile using the Short Messaging System (SMS) technology where select data is pushed to the mobile device. The wireless application protocol (WAP) technology, which will allow user to surf the net on their mobiles to access anything and everything. This is a very flexible way of transacting banking business. Already ICICI and HDFC banks have tied up cellular service provides such as Airtel, Orange, Sky Cell, etc. in Delhi and Mumbai to offer these mobile banking services to theircustomers.

8) **Internet Banking:** Internet banking involves use of internet for delivery of banking products and services. With internet banking is now no longer confirmed to the branches where one has to approach the branch in person, to withdraw cash or deposits a cheque or request a statement of accounts. In internet banking, any inquiry or transaction is processed online without any reference to the branch (anywhere banking) at any time. The Internet Banking now is more of a normal rather than an exception due to the fact that it is the cheapest way of providing banking services. As indicated by McKinsey Quarterly research, presently traditional banking costs the banks, more than a dollar per person, ATM banking costs 27 cents and internet banking costs below 4 cents approximately. ICICI bank was the first one to offer Internet Banking inIndia.

Benefits of Internet Banking:

- Reduce the transaction costs of offering several banking services and diminishes the need for longer numbers of expensive brick and mortar branches andstaff.
- Increase convenience for customers, since they can conduct many banking transaction 24 hours aday.
- Increase customerloyalty.
- Improve customeraccess.
- Attract newcustomers.
- Easy online application for all accounts, including personal loans andmortgages

Financial Transaction on the Internet:

- **Electronic Cash:** Companies are developing electronic replicas of all existing payment system: cash, cheque, credit cards andcoins.
- **Automatic Payments:** Utility companies, loans payments, and other businesses use on automatic payment system with bills paid through direct withdrawal from a bankaccount.
- **Direct Deposits:** Earnings (or Government payments) automatically deposited into bank accounts, saving time, effort andmoney.
- **Stored Value Cards:** Prepaid cards for telephone service, transit fares, highway tolls, laundry service, library fees and schoollunches.
- **Point of Sale transactions:** Acceptance of ATM/Cheque at retail stores and restaurants for payment of goods and services. This system has made functioning of the stock Market very smooth andefficient.
- **Cyber Banking:** It refers to banking through online services. Banks with web site "Cyber" branches allowed customers to check balances, pay bills, transfer funds, and apply for loans on theInternet.

9) Demat: Demat is short for de-materialisation of shares. In short, Dematis a process where at the customer's request the physical stock is converted into electronic entries in the depository system. In January 1998 SEBI (Securities and Exchange Board of India) initiated DEMAT ACCOUNT System to regulate and to improve stock investing. As on date, to trade on shares it has become compulsory to have a share demat account and all trades take place throughdemat.

How to Operate DEMAT ACCOUNT?

One needs to open a DematAccount with any of the branches of the bank. After opening an account with any bank, by filling the demat request form one can handover the securities. The rest will be taken care by the bank and the customer will receive credit of shares as soon as it is confirmed by the Company/Register and Transfer Agent. There is no physical movement of share certification any more. Any buying or selling of shares is done via electronictransfers.

- If the investor wants to sell his shares, he has to place an order with his broker and give a "Delivery Instruction" to his DP (Depository Participant). The DP will debit hi s account with the number of shares sold by him.
- If one wants to buy shares, he has to inform his broker about his Depository Account Number so that the shares bought by him are credited in to hisaccount.
- Payment for the electronic shares bought or sold is to be made in the same way as in the case of physicalsecurities.

10) WealthManagement:

Wealth management is one of the many investment services offered by banks. It allows the customers to plan their finances to grow long-term wealth. Apart from all this, banks also offer several auxiliary services to the customers such as solvency certificates, mutual funds, insurance services, gold coins, and more. Today, we have a fairly well-organized and highly sophisticated banking system that includes new-generation banks along with traditional banks. In the banking industry of India, there has been extraordinary growth that has replaced traditional banking methods with simplified, accurate, and fast banking methods. Indian banks are subject to tremendous change and are expected to expand invariably.

SERVICES OFFERED BY BANKS

The services offered by banks can be broadly classified into four categories.

1. Payment services: The Payment service is the backbone of the entire money flow in an economy. Previously the payment system was supported by cheques, demand drafts etc., which have now been replaced with direct online money transfer with the evolution oftechnology.

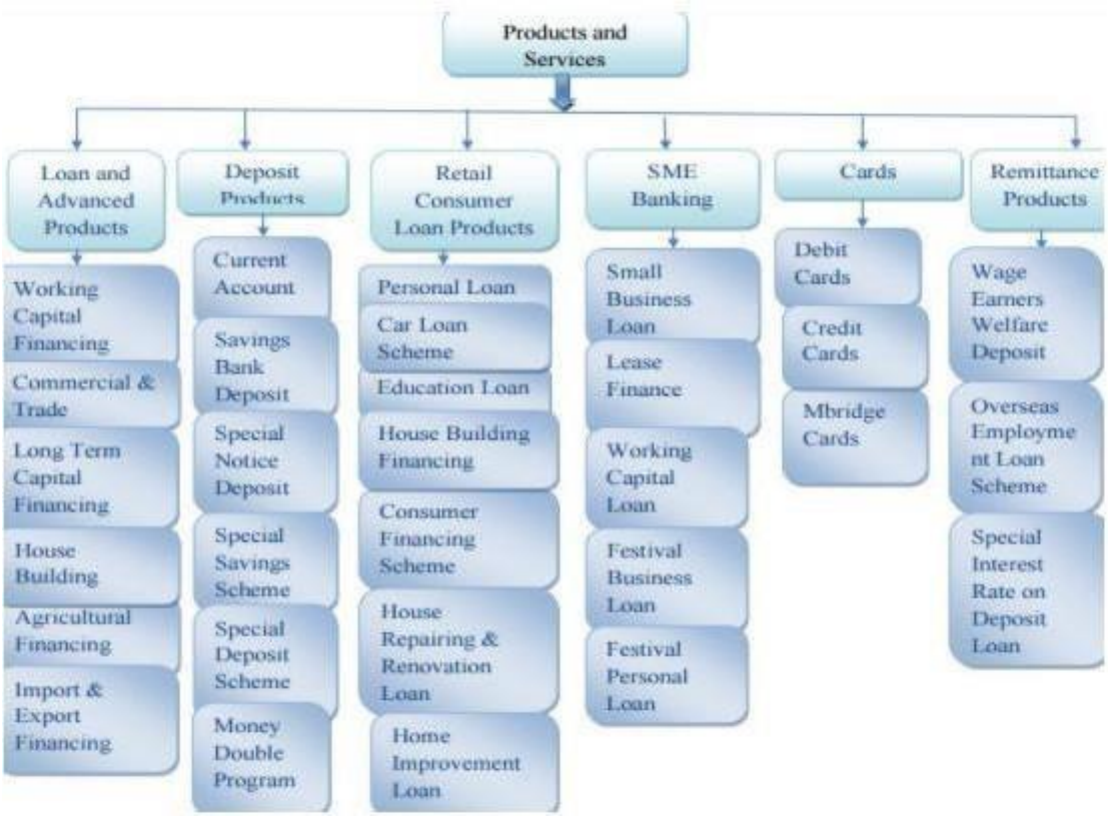
2. Financial intermediary: This is one of the oldest functions of the bank which specifies accepting deposits from customers and then lending these funds to borrowers. This is the main core business of the banking system and will continue as long as the banking systemexists.

3. Financial Services: Financial services include new services which were launched by different financial institutions with time. These services include investment banking, foreign exchange business, line of credit services, wealth management and broking services. These services generateincomeforthecommercialbankintheform ofcommissionsetc.,whichisalsotermed

as non- fund income for banks. 4. Ancillary Services: other services that the banks offer to the common men along with the necessary banking services. These ancillary services form a very minuscule of the services offered by the banks. Typical ancillary services include safe deposits lockers for gold, cheque pick up facility, door step banking etc.

Traditional Vs. New services offered by Banks

S.No	Traditional Services offered by Banks	New Services offered by banks
1	Offering savings deposits	Financial Advisory services
2	Currency exchange transactions	Credit, debit cards and gift cards
3	Providing business or personal loans	Cash management
4	Providing car and home loans to retail customers	Equipment Leasing
5	Safe keeping of Valuables	Venture Capital loans and private equity funds
6	Supporting government activities with credit by purchasing government bonds	Insurance services
7	Offering trust services, other property and financial management related services for a fee.	Retirement plans
8		Equity trading and Investment services
9		Mutual fund
10		Investment banking services
11		Wealth management



DEPOSIT PRODUCTS

- SavingsAccount
- CurrentAccount
- Recurring DepositAccount
- Fixed DepositAccount

CREDIT PRODUCTS

Consumer Loan - Consumer loan is a credit, lent to an individual for personal usage for purchasing specific item or service. With the consumer loan you can purchase domestic equipment, small household items, everyday items ro finance travel or other ongoing expenses. As a rule, consumer loan is a short-term loan. Thus, in comparing with the other loan is more expensive. Interest rate depends on loan term, volume and your income.

Mortgage Loan-Mortgage is a long-term, secured loan, whereas you can buy, build or repair immobile property, like apartment, cottage house, parcel of land. Securing of mortgage with immobile property means that if you fail to fulfill the taken liabilities during the loan period, Bank is entitled to realize the immobile property.

Auto Loan-Auto Loan is a determined type of loan, whereas consumer is allowed to purchase desirable car, new or secondary one. Generally, loan is secured by the purchased vehicle and until full coverage of the loan, bank keeps it under security. Insurance of the vehicle is a must, insurance fee is based on vehicle price and purchased package. In case of Auto loan, one can secure immobile property, instead of thevehicle

Installment-Installment is a consumer kind of loan, aimed for purchasing specific item or service from the shop/shopping center. Unlike the consumer loan, installment has specific purpose, for example, purchasing of domestic appliances, vehicle. As a rule, installment is an instant, directly in the shop or shopping center. Please consider that in some cases, price of the item/service purchased via installment is higher than the price purchased directly with own existing funds.

Overdraft-Overdraft is a short term loan, allowed on the card account of the costumer. Sometimes, overdraft is called thirteenth salary and is launched corresponding to the salary (as a rule, amount of overdraft is 90% of the salary, though in some banks it could be more than salary). Usually, overdraft term is 1 year, only accrued interest rate is cut off from monthly transferred salary and principle sum is covered at the end of theterm.

Overdraft allows the customer to use the sum, more than the customer deposits/owns. Maximum sum is verified individually, based on the credit history and income of the customer. Overdraft is almost similar to credit card though, the difference is that it is attached to the salary and privileged period doesn't affect on consumed funds.

Credit Cards - Credit Card is the hybrid creature of the two bank products - plastic card and consumer loan. This is bank product allowing the customers to purchase item or service, including via internet and/or withdraw cash from the ATM.

Credit limit or maximum amount of loan, is verified individually, based on the credit history and income of the customer.

Credit limit can be increased. Customer can consume money at any time and period, under the given limit. Correspondingly, credit card has no standard schedule of coverage. Most of the credit cards have privileged period, whereas interest rate is not accrued on consumed sum in case of full coverage. If the costumer failed to cover the consumed sum during the privileged period, customer is obliged to cover specific part of the consumed sum at the end of the contractual period. It should be considered that commission rate for cash withdrawal is very high, so it is recommended to use the credit card via POS terminals at shoppingcenters.

What is Custody?

"Custody means holding, directly or indirectly, client funds or securities, or having any authorityto obtain possession of them. You have custody if a related person holds, directly or indirectly, client funds and securities, or has any authority to obtain possession of them, in connection with advisory services you provide toclients.

Custody includes: •

(i) Possession of client funds or securities (but not of checks drawn by clientsand made payable to thirdparties)

(ii) Any arrangement (including a general power of attorney) under which you are authorized or permitted to withdraw client funds or securities maintained with a custodian upon your instruction to the custodian;and

(iii) any capacity (such as general partner of a limited partnership, managing member of a limited liability company or a comparable position for another type of pooled investment vehicle, or trustee of a trust) that gives you or your supervised person legal ownership of or access to client funds orsecurities.

Meaning of Custodial Services

□It is one of the financial services in which a brokerage or other financial institution holds and manages a client's securities or other assets on their behalf.

A Custodian provides an investor a place to store assets with little risk. This reduces the risk of the client losing their assets or having them stolen. They are also available to sell through the brokerage at the client's demand.

The custody business provides a range of security services, like safekeeping and settlement, dividends collection and distribution, proxy voting, tax reclaim services, fund administration and providing market news.

Who needs Custody Services?

- Private Banking & Wealth Managementcustomers
- Corporations
- Investmentfirms
- Insurance Companies
- Finance Firms
- Institutionalinvestors
- Domestic & InternationalBrokers
- Sub-Custodians
- Fund & AssetManagers
- Medium to small sizedBanks
- SecuritiesIssuers
- Private Investors

How does a Custodian generate fee income by offering Custodial Services?

• Stock Borrow Lending financing &servicing

• Trade finance settlement – fees can be charged for assets under management that are used as security in trade finance, provision on loans etc

• Fee generation and income collection facilities andcapabilities

• The generation of fees through the management of Corporateactions

• The generation of fees through Proxy votingservices

• The generation of fees through Banking transactions for dividend paymentsetc

• The generation of fees through Reporting of actions toclients

• The generation of fees through Provision of market information toclients

• The generation of fees through FX transactions when the Securities are heldoverseas

Why the Need for a Custodian?

• The use of a custodian in both mature and emerging securities markets is considered an international bestpractice

• In most jurisdictions there is often a regulatory requirement to provide CustodialServices

• It allows Investors, Fund & Asset Managers to concentrate on their expertise on the management ofinvestments

• The safe keeping of assets helps to reduce market and counterpartyrisk

• It provides an opportunity for the Custodian to generate fees and income from Asset Servicing activities

Attributes of a Custody Service

A Custody Service should include facilities for the Deposit and Safekeeping, Withdrawal, Regular Transfer, Restricted Deposits and Transfer, Reorganization, Branch Deposits, and Physical Clearance and Settlement services. A Custody Service provides:

• A Custodian provides Security for your assets in an approved Securevault.

• A Custodian should provide the assignment of a unique reference identification number to all securities custodydeposits.

• An Asset Servicing & Custody Service should provide a continuous & random audit checks on asset undermanagement.

• It should provide reasonable availability of detailed information on every certificate held under custody.

• Choice of interface and access to the Banks' CustodyService

• Availability of end-of-day positions and activity reports on the same files as other positions and activities

• Availability of images of all certificates and other documents held incustody.

What a Custodian does not do?

• A Custodian does not Executetrade

• A Custodian does not generally advise on investmentselection

• A Custodian does not advise on corporate actionselection

• A Custodian does not advise on proxyvoting

• A Custodian does not organise trades between clients

• A Custodian acts only as a custodian or an administrator ofsecurities

• Clients' assets are separated from those of the Custodian Bank often through the establishment of a nominee company to safeguard clients' assets Custodians are Not Beneficial Owners of Securities!

Example:

Kotak Group, a premier financial services provider and one of the leading private sector banks in India, proudly launches Custody Services as part of its diversified services portfolio in capital markets industry. A dedicated team of experienced professionals and emphasis on the latest state of the technologies have made Kotak Group being at the forefront of financial products and services in Indian capital markets for overseas and domestic investors.

The Custody Services division at Kotak Mahindra Bank Ltd., (KMBL) iscommittedto delivering top of the securities services to institutional investors, both foreign anddomestic,that would be investing in the Indian capital markets across debt and equity instruments, derivatives, Depository Receipts and mutualfundunits.

Key Features

Custody and Settlement Services

Depository Receipts

Escrow Accounts

Foreign Direct Investment

Internet Interface for Clients

Custodial services provided by KMBL

1. Account Opening: Kotak Mahindra Bank would assist clients for the custody account opening documentation requirements and facilitate clients during the SEBI registrationprocess.

2. Securities Safekeeping: Provides safekeeping services for securities held both in electronic as well as physicalforms

3. Corporate Actions: KMBL custody tracks for corporate actions processing on behalf of its clients. This involves application made to issuers on behalf of clients, income collection and following-up for corporate action events like dividend, interest, redemption,bonus,

4. Foreign Exchange Services: KMBL has a dedicated foreign exchange desk that takes care of client needs for currency conversions and risk managementproducts.

5. Proxy Services: KMBL would act on client instructions and participate and vote on their behalf in shareholders' meetings ofcompanies.

6. Compliance Monitoring and Regulatory Reporting: KMBL would monitor compliance to existing guidelines by investors and facilitate reporting to regulators and local authorities on behalf of theclient.

7. Transaction Settlement: As a Clearing Member with the clearing houses ofleading

8. Standardized and Customized Reporting: Investors need meaningful information that offers insight to their investment portfolios. It also provides customized reports to clients at various frequencies to enable clients to efficiently manage their securities portfolio, cash balances and take more informed investmentdecisions.

Credit Appraisal – Overview

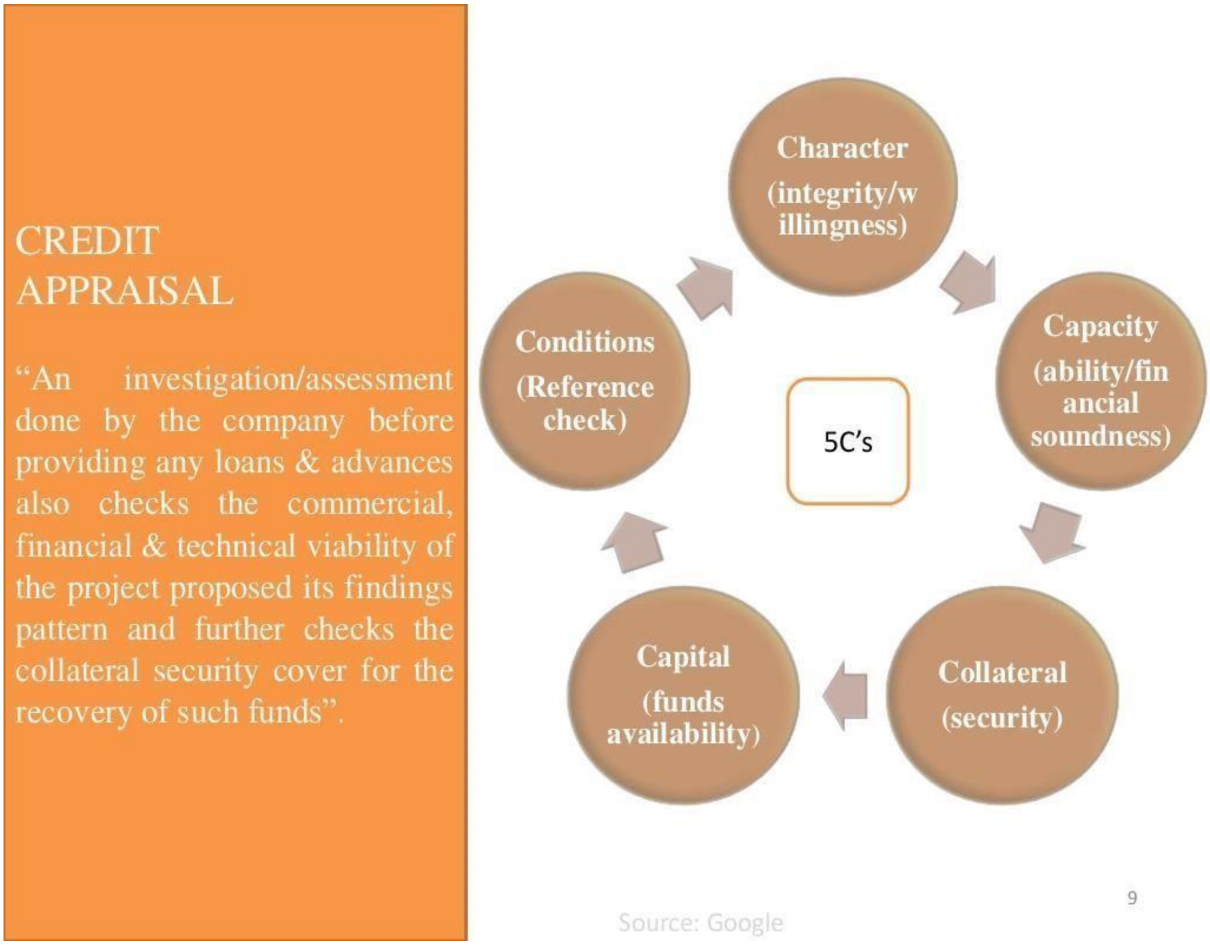
Credit Appraisal is a process to ascertain the risks associated with the extension of the credit facility. It is generally carried by the financial institutions, which are involved in providing financial funding to its customers. Credit risk is a risk related to non-repayment of the credit obtained by the customer of a bank. Thusit is necessary to appraise the credibility of the customer in order to mitigate the credit risk. Proper evaluation of the customer is performed this measures the financial condition and the ability of the customer to repay back the Loan in future. Generally the credits facilities are extended against the security known as collateral. But even though the Loans are backed by the Collateral, banks are normally interested in the actual loan amount to be repaid along with the interest. Thus, the customers cash flows are ascertained to ensure the timely payment of principal and theinterest.

It is the process of appraising the credit worthiness of a Loan applicant. Factors like age, income, number of dependents, nature of employment, continuity of employment, repayment capacity, previous loans, credit cards, etc. are taken into account while appraising the credit worthiness of a person. Every bank or lending institution has its own panel of officials for thispurpose.

If any one of these is missing in the equation then the lending officer must question the viability of credit. There is no guarantee to ensure a Loan does not run into problems; however if proper credit evaluation techniques and monitoring are implemented then naturally the Loan loss probability/problems will be minimized, which should be the objective of every lending officer.

Credit Appraisal – Meaning

“An investigation/assessment done by the company before providing my loans &advances also checks the commercial, financial &technical viability of the project proposed its findings pattern and further checks the collateral security cover for the recovery of such funds”.



If any one of these is missing in the equation then the lending officer must question the viability of credit. There is no guarantee to ensure a Loan does not run into problems; however if proper credit evaluation techniques and monitoring are implemented then naturally the Loan loss probability/problems will be minimized, which should be the objective of every lending officer.

Components of Credit Appraisal process/Mechanism

We can tabulate all the conditions under three parameters:

PARAMETER COMPONENTS & HOW BANK ASSES YOUR CREDITWORTHINESS THROUGH IT

Technical Feasibility	What bank is looking for
Living standard	Decent living standard with some tangibles like T.V. & fridge will provide assurance to bank regarding your residential status.
Locality	Presence of some undesirable elements like local goons or controversial areas adversely affects your loan appraisal process.
Telephonic Verification	At least one response is need from person to establish the identity of the person from contact point of view.
Educational Qualification	Not an essential barrier but essential to understand the complex terms & conditions of bank loan.
Political Influence	An interesting reference point in the sense that they are one of major category of loan defaulters.
References	To establish the residential identity of person from human contact point of view & cross check of their loans.

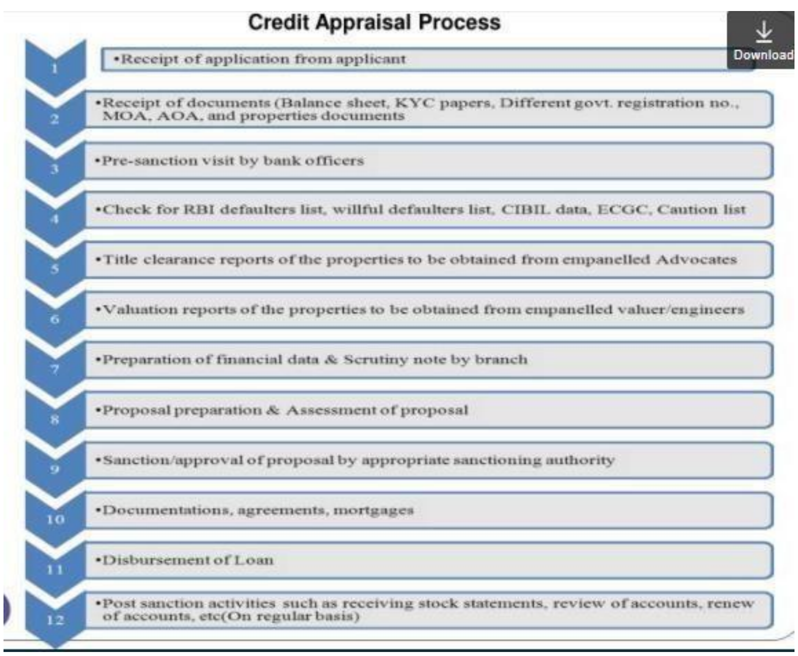
Economic Parameters

MPBF	Maximum Permissible bank finance calculation is done on the basis of loan amount.
Ratio analysis	To check the financial position and repayment capacity of the borrower.
Financial statements	To find out the current and projected value of borrower income.
IRR	Internal Rate of Return is calculated of the borrower.
DSCR	To check the ability of the project to generate sufficient cash flows to repay the debt taken to finance the project.

Bankability Parameters

Parameter	Norms	Checkpoints
Bank Statements	12 months bank statements need to be furnished	To check the average amount client is maintaining in the account is sufficient to pay the installment amount or not.
Business continuity proof	Two year IT returns made compulsory	To enquire primary source of income.
Credit interview	For the big loan amount credit interview is necessary.	To check the general attitude of customer along with efforts are put in to understand their needs better.
Security	Asset of value equal to or more than loan amount taken has to be put as pledge or collateral.	To safeguard bank interest against any future default.
Ownership title	To be on the name or blood relative of applicant.	To establish the ownership claim of the loan applicant.
CIBIL Report	To check the credit history of the applicant.	Bank tool to check any default incidence in loaning history of applicant.

CREDIT APPRAISAL PROCESS



Principles of Credit Appraisal

1. Pay attention to quality of credit, rather than quantity
2. Every loan must have a 3-way exist route to meet all eventualities
3. Focus on the character and antecedents and decedents of the borrower
4. Do not lend to a business you don't understand
5. Lend only when feel comfortable about doing so
6. Know all the facts
7. Be conscious of the business cycles and their impact
8. Understand the management and its style of operation
9. Collateral is desirable, but it never is a replacement for repayment
10. Size does matter
11. Pay attention to even small details
12. Stay away from borrowers who can't get loans from local banks
13. Don't be rushed
14. Concentrate on where is the loan money is going?
15. Bank comes first – never make a loan to someone you personally won't give a loan

Loan products of Bank

Bank's loan products are a very sensitive area of operation. There are six basic principles of lending that have been followed by banks since long. These principles are **Safety, Liquidity, Profitability, Purpose, Diversification of Risks and Security.** Each bank is having its own internal guidelines to ensure that the basic principles of lending are followed. However, though the products may vary in their names, the Asset products which are almost common to all banks. Basically, Banks are required to lend 40% of advances to `Priority Sector', 25% of which should be lent to `Weaker Section' in terms of Reserve Bank of India guidelines.

Fund Based and Non-Fund based lending

Broadly, the lending function can be Fund Based or Non-Fund Based. As the name suggests, Fund Based Loan product Facility involves actual outlay of Cash from Bank to the Loan Borrower who needs the fund for personal or business activity. There are various types of loanand we shall learn about the same in due course. Let's understand the concept of Fund Based Lending, below is the classification.

- Fund Based Credit Facilities – Direct Loans tocustomer
- Non-Fund Based Lending – Bank Guarantee & Letter ofCredit

Types of Fund BasedCredit

CashCredit

In practice, the operations in cash credit facility are similar to those of overdraft facility except the fact that the company need not have a formal current account. Here also a fixed limit is stipulated beyond which the company is not able to withdraw the amount. Legally, cash credit is a demand facility, but in practice, it is on a continuous basis. Interest is payable on amount actually availed, and is calculated on a daily productbasis.

Bills Discounting/Bills Purchase

This form of assistance is comparatively of recent origin. This facility enables a company to get immediate payment against credit bills raised by them. The bank holds the bill as a security till payment is made by the customer. The entire amount of bill is not paid to the company.

The Company gets only the present worth of the amount of bill, the difference between the face value of the bill and the amount of assistance being in the form of discount value. On maturity, bank collects the full amount of bill from the customer. While granting this facility to the company, the bank inevitably satisfies itself about the credit worthiness of the customer. A fixed limit is stipulated in case of the company, beyond which the bills are not purchased or discounted by the bank.

Working Capital Term Loans

To meet the working capital needs of a company, banks grant working capital term loans for a period ranging between 3 to 7 years, payable by yearly or half yearly installments.

Packing Credit

This type of assistance may be considered by banks to take care of specific needs of the company when it receives some export order. Packing credit is a facility given by a bank to enable the company to buy the goods to be exported. If the company holds a confirmed export order placed by the overseas buyer or a letter of credit in its favor, it can approach the bank for packing credit facility.

Buyer's / Supplier's Credit

These are similar to Bills Discounting / Bills Purchase. A manufacturing venture requires such types of Credit facilities, which are self-liquidating in nature. These facilities are more relevant to Financing of Foreign Trade: Imports &Exports

Term Loans

Term loans are a type of long-term loans that can last anywhere between one year to thirty years. It is repaid throuh regular payments at a fixed or floating interest rate. Term loans are sanctioned for acquisition of fixed assets like land and building, plant and machinery, equipment and furniture fixtures, vehicles etc.

Banker has to ensure the end use of the amount lent and hence amount lent is directly given to the supplier of the fixed asset and proper invoice is obtained for record. Banks have been financing new business ventures and also have been funding the total financial needs, including term loans of both new and existing units of all sizes. The company / firm has to provide margin money through company's capital to get the loan whereby the cost of project is partly funded through own funds (called margin) and the balance through borrowing from financial institutes like banks

Working Capital Facility

Working Capital facility is the credit taken out for a short term, usually for a year renewable periodically, for financing the day-to-day operations of a company. This working capital is used to fund the employees' salaries, accounts payable, raw materials, advertising etc.

In case of working capital finance the stock of material purchased through the finance from banks, the outstanding gets cleared from the proceeds of sale of finished goods and thus working capital finance is self-liquidating through the completion of operating cycle and is a continuous process.

Whereas the term loan once paid off through the profits of the business is not raised for the same purpose. When Term Loans are given the repayment should be feasible from the profits of the company.

Non-Fund based credit facilities

Non-Fund based Credit facilities do not involve actual fund flow from bank to customer, ie, there is no credit extended to the customer. It is a sort of assurance or security to the third party involved in a transaction on behalf of its customer that in the event thef customer fails to pay back the dues, Bank takes the onus for the same. The Non-Fund based Loan Facilities provided by banksare:

Bank Guarantee (BG)

In a BG or Bank Guarantee, the bank gives a commitment in the approved format on behalf of its customer to a third party, for a fixed sum of money for a fixed period of time. The bank charges the customer a percentage of that amount as commission (normally near about 3%p.a.).

The bank does not have to part with any money. However, the liability arises as and when the customer defaults on payments. The banker makes good the loss of money as per the guarantee contract, which is called invocation of guarantee by the beneficiary. Banker then recovers this money from the customer on whose behalf the guarantee was issued. Part of the BG is secured by margin money and balance is secured by collateral security like immovable property or stocks and book debts or any tangibleasset.

Customers can avail services or buy goods without borrowing money which means they don't have to pay interest either. Customers can also service contracts or obtain contracts without borrowing interest-heavy funds.

Letters of Credit (L/C)

LC is an integral part of all import and export transactions. The Letter of Credit helps the seller to get his money from the buyer living in another City or Country. LCs can either be inland or foreign.

Generally, in an international trade, seller may not be willing to sell the goods to the buyer unless he is certain about payment. The risk in dealing with unknown buyer can be very high. The buyer may not retire the bill in which case the seller has to incur substantial expenditure for finding an alternate buyer, import of goods etc. So, seller wants an assurance that he will be paid in full within the agreedtime.

Similarly, a buyer wants an assurance that he does not have to pay the seller until he is certain that a seller has fulfilled his obligations as per agreement. Under these circumstances, banks issue an LC or letter of credit to facilitate the payment of the tradetransactions.

The main documentation required to avail L/C are:

- Value of Raw materials consumed and of which on credit fromsupplier.
- Time taken for reaching L/C to thebeneficiary
- Time for shipment & consignment to reach customer'sdestination
- Period granted by the seller to the buyer
- The entire time taken from issue of L/C to retirement of L/C and MPBFworkings

Risks involved in Lending and mitigation processes

- If staff misjudge either the business or the borrower, it is difficult to fix the problem once the loan isgranted.
- Careful evaluation of the business viability and borrower character are essential to lending unless the organization can rely on (a) collateral, (b) cross-guarantees within agroup of borrowers, or **(c)** social pressure networks.
- While alternatives to traditional collateral have worked well in certain developing countries, they have worked less well in othercountries
- Prudent judgments of business viability and borrower character areessential.

Credit Monitoring

- Credit Information Bureau India Limited or more commonly known as CIBIL is the most critical player in the finance industry. Set up in August 2000, they help many financial institutions with providing loans to customers and even help them manage their business. CIBIL is the credit monitors on the country, they maintain records of an individual's financial transaction history pertaining to loans, credit cards etc. from the many banks and lending institutions in the country. With this information they create reports with will pertain to the individual's financial transaction history, called Credit Information Report which also provide the individual with a score. The score of the individual will allow many banks and financial institutions to provide a loan of any kinds to an individual, since CIBIL has checked his/her repaying capability.

Benefits on Credit Monitoring

- It provides individuals with reports if any changes occur on their history, with also provides your score and report.
- With credit monitoring, the possibility of credit fraud and identity theft is curtailed due to monitoring.
- Alerts provided to the individuals on their important activities, such as credit history, credit inquires, delinquency, records of public nature, and even any other negative information.

7 Things you won't find on your CIBIL report

- Savings and investment data
- Credit approval status and analysis
- How to improve your credit score

- Your credit utilization ratio
- Reason for settlements
- Defaulters list
- Monthly payment history beyond 3 years

Performing Asset

An account does not disclose any problems and carry more than normal risk attached to the business

• All loan facilities which are regular.

Non-Performing asset

Non-Performing Asset means a loan or an account of borrower, which has been classified by a bank or financial institution as sub-standard, doubtful or loss asset, in accordance with the directions or guidelines relating to asset classification issued by RBI.

Factors Impacting rise in NPAs

- **External factors :**

  Ineffective legal framework & weak recovery tribunals

  Lack of demand / economic recession or slowdown

  Change in Govt. policies

  Willful defaults by customers

  Alleged political interferences

- **Internal factors :**

  Defective Lending process

  Inappropriate / non –use of technology like MIS , Computerization

  Improper SWOT analysis

  Inadequate credit appraisal system

Managerial deficiencies

Absence of regular industrial visits & monitoring • Deficiencies in re-loaning process

Alleged corruption

Inadequate networking & linkages b/w banks

Why Loan accounts go Bad?

- **BORROWER-SIDE**

  - Lack of Planning

  - Diversion of Funds Disputes within No contribution No modernization Improper monitoring Industrial Relations Natural Calamities

BANKER – SIDE

-Defective Sanction

-No post-sanction supervision, etc

-Delay in releases

-Directed lending

-Slow decision-making process

Non-Performing Assets – Types

- Sub-Standard Assets: An asset which has remained NPA for a period less than or equal to 12 months.
- Doubtful Assets: An asset that has remained in the substandard category for a period of 12 months.
- Loss Assets: An asset where loss has been identified by the bank or internal or external auditors or the RBI inspection but the amount has not been written off wholly.

NPA -Management Strategies

a. Preventive Management - It is rightly said that prevention is better than cure.

- Developing 'Know Your Client' profile (KYC)

-Monitoring Early Warning Signals

-Installing Proper Credit Assessment and Risk Management Mechanism

-Reduced Dependence on Interest

-Generating Watch-list/Special Mention Category

b. Curative Management

- Re-phasement of loans

- Pursuing Corporate Debt Restructuring (CDR)

-Encouraging rehabilitation of potentially viable units

-Encouraging acquisition of sick units by healthy units

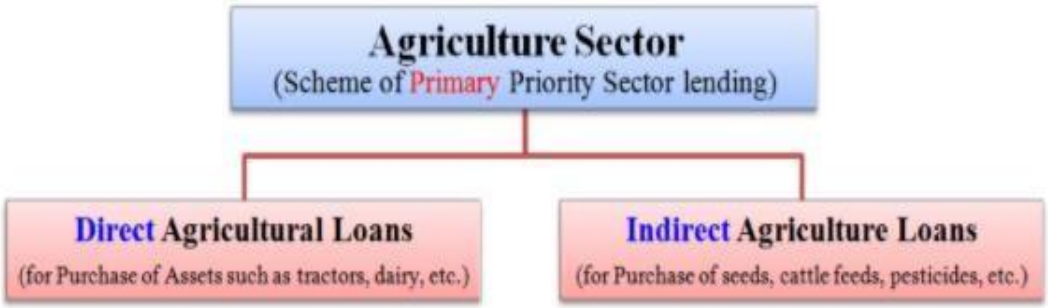
- Entering compromise schemes with borrowers / Entering one-time settlement

Tools for Recovering NPA

- Using Lok Adalats for compromise settlement for smaller loans in "doubtful" and "loss" category.
- Using Securitization & SARFAESI Act (Securitisation and Reconstruction of Financial Assets and Enforcement of Securities Interest Act, 2002)
- Using Asset Reconstruction Company (ARC)
- Approaching Debt Recovery Tribunals (DRTs).
- Recovery Action against Large NPAs
- Circulation of Information of Defaulters
- Strengthening Database of Defaulters

Priority Sector Lending

- Priority sector as the sectors of economy involving Agriculture Finance, Retail Trade, Small Enterprises, Education Loans, Micro Credit and housing loans.
- The Reserve Bank of India, describes Priority sector lending norms to include the following areas:



Categories under Priority Sector Lending

(i) Agriculture

(ii) Export credit

(iii) Education

(iv) Housing

(v) Social Infrastructure

(vi)Renewable energy and others

Priority Sector Lending:

The PS advances relates to the facilities granted to

- Agriculture (Direct andIndirect)
- MSME (Micro Small and Medium Enterprises)
- SmallBusiness
- RetailTraders
- Professional and selfemployed
- EducationLoan
- Vehicle Loan
- House/Home Loans
- Mortgage Loans
- Small and Water TransportOperators
- Loan to WeakerSections

Also, the Retail Loan sector is growing these days very fast, which include, Consumer Loans, Salary Loans, Personal Loans, Credit Card Loans and Retail Sectors. The Indian Loan market through banks and non-banking financial companies have grown multi-fold during the last decade and the growth is stillcontinuing.

Priority sector lending norms to include the following areas:

- **Small scale industries**, this includes loans for setting up of industrial estates also.
- Small road and water transport operators with a limit for owning upto 10 vehicles.
- Small business, where the cost of equipment used for business does not to exceed 20 lakh rupees.
- Retail trade, with loans upto rupees 10 lakh.
- Professional and self-employed persons, with the borrowing limit upto 10 lakh rupees, with many terms and conditions.
- State sponsored organizations for upliftment of Scheduled Castes/Scheduled Tribes
- Education sector, includes educational loans to individuals.
- Housing includes both direct and indirect loans with different limits set for rural and urban areas
- Consumption loans covered under Consumption Credit scheme being run for weaker sections.
- Micro-credit to self-help groups(SHGs) or Non-Governmental Organizations (NGOs).
- Loans to the software industry upto Rs 1 crore rupees.
- Loans to the specified industries operating in the Food and Agro-processing sector, which have an investment in plant and machinery not exceeding Rs 5 crore.
- *Loans to sanitation, health care and drinking water facilities and renewable energy*. (newly added)
- Bank Investment in venture capital funds or companies that are registered with SEBI.

Minimum Limits for Priority Sector Lending

- The minimum limits are prescribed by RBI according to the ownership pattern of banks.
  - For all local banks in both public and private sectors are required to lend 40% of their net bank credit (NBC), to the priority sector.
  - For foreign banks the minimum limit is 32% of their NBC (Net Banking Credit) to the priority sector.

Factoring -Meaning and Definition

Factoring is derived from a Latin term “facere” which means ‘to make or do’. Factoring is an arrangement wherein the trade debts of a company are sold to a financial institution at a discount. The factor is an agent who buys the accounts receivables (Debtors and Bills Receivables) of a firm and provides finance to a firm to meet its working capital requirements.The main advantage of factoring is that the small or big business firm receives short term finance (working capital) to meet day-to- day payments.

In a report submitted to the Reserve Bank of India, Mr.C.S.Kalyanasundaram defines factoring as “*a continuing arrangement under which a financing institution assumes the credit and collection functions for its clients, purchases receivables as they arise (with or without recourse for credit losses, i.e., the customer’s financial inability to pay), maintains the sales ledgers, attends to other book-keeping duties relating to such accounts, and performs other auxiliary duties*”.

The Factoring Regulation Act 2011 governs the registration of factors and regulating the assignment of receivables and the associated obligations.

It is an arrangement between a factor and his client which includes any two of the following services provide4d by the factor to the client –

- Finance
- Maintenance of account
- Collection of debts
- Protection against credit risk

Through factoring an organization (client) relieves itself from the procedures and expenses of collecting receivables arising out of a sale and receives immediate cash to finance its business operations.

A factoring agreement involves three parties:

- The Factor
- The Client (sells receivables to factor)
- Customer (pays to factor)

Features of factoring

1. It is very costly.
2. In factoring there are three parties: The seller, the debtor and the factor.

3. It helps to generate an immediate inflow of cash.

4. Here the full liability of debtor has been assumed by the factor.

5. Factor has the right to take any legal action required to recover the debts.

Functions of a Factor

(a) Maintaining Accounts – Preparing and updating sales ledger and providing periodic reports with useful information

(b)Providing advisory services – Advices the client regarding credit worthiness of a buyer, potential customers, market trends etc.

(c)Providing Short term finance – Provide money in advance up to 80% of the receivables

(d)Providing Credit Protection – Protects the client against bad-debts/non-payment.
(e)Providing collection facilities – Collect money on behalf of the client and remits the money back after deducting his charges.

Factoring has several advantages, some of which are:

The company receives advance payment from the factor which improves its immediate cash inflows. Factoring does not require to chase the debtors for collecting outstanding amount and consequently the management may concentrate on other important issues.

Disadvantages of Factoring*:*

Factoring is also associated with some disadvantages such as:

(i) It is very costly, as a huge discount is to be paid to the factor.

(ii) Factors may adopt some harsh techniques for the recovery of debt which is not always acceptable to the debtors and ultimately the relationship between company and debtors deteriorates.

(iii) Factors only purchase the invoices of a reputed company; a new company does not get the benefit of factoring.

Mechanism of Factoring

A factoring contact for sale of receivables -

It starts with a credit sale and agreement between the client and the buyer/customer.

The client (seller)

Sells goods on credit to buyer/customer

Prepares invoice, delivery challan, factoring agreement and other documents

Hands over the documents to factor (financial institution/Banking Institution)

Receives payment in advance upto 80% of cost of good by the factor.

The Factor

Makes an advance payment to factor on receiving all the documents (invoice, challan, agreement etc.)

Prepares and sends periodical account statements to customer.

Receives payment from customer/buyer on due date

Remits the balance (20%) from the money collected to the clients/seller after deducting its commission, fees,sevices charges etc.

Advantages of Factoring

To Client/Seller

The client gets immediate cash on sale which can be invested somewhere else.

It protects the client against credit risk i.e.risk of non-payment by buyer.

It allows the client to offer lucrative credit schemes to customers and increase his sales and profit.

It reduces the financial burden of the client and relieves him maintain accounts and collection of receivables.

It acts as an additional source of finance for the client and allows him to explore new markets.

To Customers/Buyers –

It allows customers to save bank charges and expenses

It allows customers to purchase expensive products through flexible credit schemes

The factoring procedure is simple and easy than applying for a bank loan, it saves time, money and effort.

Types of Factoring

(a) Full-service factoring or Without recourse factoring:

When a factor agrees to provide complete set of services which includes financing, maintenance of sales ledger, debt collection at his own risk, and providing consultancy services as and when necessary, it is called as full servicing factoring.

(b) With recourse factoring

When the factor does not undertake credit risk, it is known as with recourse factoring. In case the debtor fails to make the payment on due date, it is assigned back to the firm by the factor. Here the responsibility of collecting the amount lies with the selling firm.

(c) Maturity factoring

In this type, the factor agrees to finance the firm only after collecting the amount on maturity from debtors.

(d)International factoring

When the claims of an exporter are assigned to a financial institution and the finance is advanced on the basis of export invoice it is called as international factoring.

Factoring Process

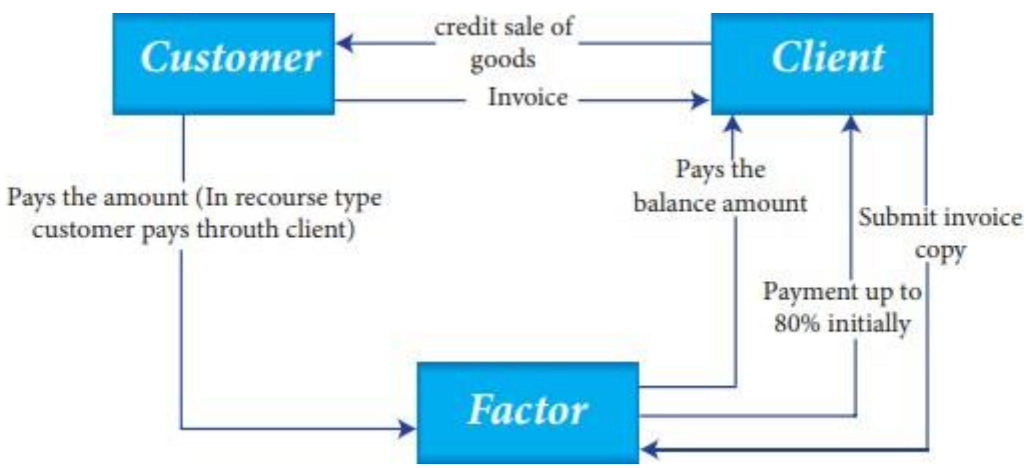
a. The firm enters into a factoring arrangement with a factor, which is generally a financial institution, for invoice purchasing

b. Whenever goods are sold on credit basis, an invoice is raised and a copy of the same is sent to the factor.

c. The debt amount due to the firm is transferred to the factor through assignment and the same is intimated to the customer.

d. On the due date, the amount is collected by the factor from the customer.

e. After retaining the service fees, the remaining amount is sent to the firm by the factor



Ancillary services

Each bank has two main activities as the sourcing or borrowing of funds (as deposits and capital from the market) and the deploying or lending the funds as Loans and Investments): these form the traditional and core activities of all the banks.

Apart from these basic activities, the banks provide a variety of other services or products.The most popular ones are listed below.

1) **Funds transfer service:** Useful for sending and receiving money from all over the world.The products that cover these services are Demand Drafts, Bankers Checks/Pay orders, EFT(Electronic Funds Transfer),etc. The names given to these services may vary among the banks but basically, they are the same.

2) **Forex service:** You can buy the foreign exchange for any purpose of expenditures like travel, buying

merchandise, etc.and sell the same to the bank when you earn or receive from abroad. Of course, these forex transactions are subject to the rules and regulations prevailing in a country and they are provided by only those bank branches which are approved by the Banking Authority or Regulator for this purpose.

3) **Custodial Service**: You can keep your valuables like jewels, documents, etc.under this service which is commonly known as Locker facility(Safe Deposit Vaults in banking parlance.The bank will collect a nominal fee for the service.

4) **Gold sale**: You can buy pure gold for self-consumption or for trading by the jewellery businesses.Here also, only a few selected branches of banks or banks are allowed to provide this. The products usually range from a coin to a 100gm biscuit or bar.

5) **Investment service**: Invest your money in the mutual funds run by the banks.The service comes as Portfolio service(the decision to maximize the returns on your money is left with the banker or portfolio manager) and as Stand-alone product where the decision to get maximum returns is borne by you. Bothhave the plus and minus but these products are offered to suit the convenience of the investors.

6) **Insurance sale**: A range of insurance products covering the risk of life, health, assets like vehicle, credit and debit cards, travel, etc. are offered by almost all the banks by themselves or in collaboration with the leading insurer companies, which again may be local or multinational entities.

7) **Card services**: Primarily intended for safety and convenience purpose but now, has become a payment mode and a symbol of economic status.The card products usually are called as Debit card, Credit card .

8) **E-Banking**: also known as Netbanking or Internet banking is the latest and most convenient facility of the banks. You can get id and password to operate your account online: for transfer of funds to another account in the same bank or another bank. You can keep the surplus funds in fixed deposit by using this facility.The best use of this facility is for shopping online.

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SCHOOL OF MANAGEMENT STUDIES

UNIT – 3 – Banking and Insurance Management – SBAA7001

UNIT 3 – BANKING REGULATIONS

Banking Regulation Act,1949 - KYC and AML guidelines, Banking Fraud, Cash Reserve Ratio (CRR) and Statutory Liquidity Ratio (SLR), Asset Liability Management - Capital Adequacy in Banks - Basel norms - CAMELS rating of Banks –Banking Ombudsman - SARFAESI Act.

What is Banking Regulation Act,1949?

- The Banking Regulation Act 1949 is a legislation in India, that states all banking firms will be regulated under this Act.
- There are a total of 55 Sections under the banking Regulation Act.
- Initially the law was only applicable to banks, but after 1965, it was amended to make it applicable too CO-operative banks and also to introduce other changes.
- The act provides a framework that regulates and supervises commercial banks in India.
- This act gives power to the RBI to exercise control and regulate banks under supervision.

Introduction of Banking Regulation Act 1949

- The act came into force on March 16^{th} 1949.
- It relates to various aspects vis-à-vis banking in India.
- The main objective of the banking regulation act is to ensure sound banking through regulations covering the opening of branches and the maintenance of liquid assets.

Objectives of Banking Regulation Act, 1949

The Banking Regulations Act was enacted in February 1949 with the following objectives:

- The provision of the ***Indian Companies Act 1913*** was found inadequate to regulate banks in India. Therefore a need was felt to introduce a specific legislation having comprehensive coverage on issues relating to the banking business in India.
- Due to ***inadequacy of capital***, many banks failed and therefore prescribing a minimum capital requirement was felt necessary. The Banking Regulation act brought in certain minimum capital requirement for banks.
- The key objectives of this act was to cut competition among banks. The act has regulated the opening of branches and also changing the location of existing branches.

- To prevent random opening of new branches and ensure balanced development of banks through system of licensing.
- Assigning power to RBI to appoint, reappoint and remove the chairman, director and officers of the banks. This could ensure the smooth and efficient functioning of banks in India.
- To protect the interest of depositors and public at large by incorporating certain provisions like prescribing cash reserve ratio and liquidity reserve ratios.
- Provide compulsory amalgamation of weaker banks with senior banks and thereby strengthen the banking system in India.
- Introduce provisions to restrict foreign banks investing funds of Indian depositors outside India.
- Provide quick and easy liquidation of banks, when they are unable to continue operations or amalgamate with other banks.

History of Banking Regulation Act, 1949

- Banking in India originated in the last decades of the 18^{th} Century.
- Prior to Nationalization, the majority of the banks were private banks.
- Private Banks were class based and there would be monopolies that would only benefit a few people.
- With the nationalization of the banks, the credit scenario changes benefitted all sections of society and contributed to overall prosperity.
- The Indian Government recognized the need to bring the banks under some form of Government control, to be able to finance India's growing financial needs.
- On 19^{th} July 1969, 14 major Indian Commercial banks of the country were nationalized .
- After independence, the Government of India came up with the Banking Companies Act, 1949, later changed to Banking Regulation Act, 1949 as per the amending Act of 1965, under which the Reserve Bank of India was bestowed with extensive powers for the supervision of banking in India as the central banking authority

Provisions of Banking Regulation Act, 1949

- Prohibition of trading(Section 8): According to Section 8 of the Banking Regulation Act, a bank cannot directly or indirectly deal with buying or selling or bartering of goods.

However it may barter the transactions relating to bills of exchange received for collection or negotiation.

- Non-banking asset(Section 9): A bank cannot hold any immovable property, howsoever acquired except for its own use, for any period exceeding seven years from the date of acquisition thereof. The company is permitted within a period of seven years, to deal or trade in any such property for facilitating its disposal.

- Management(Section 10): This rule states that every bank shall have one of its directors as chairman on its Board of Directors. It also states that not less than 51% of the total number of members of the Board of Directors of a bank shall consist of persons who have special knowledge or practical experience in accountancy, agriculture, banking, economics, finance, law and co-operatives.

- Minimum Capital (section 11) -prescribes a minimum capital of Rs.5.00 lakh only, Reserve Bank currently prescribed a minimum paid-up capital of Rs.100 crore for setting up a new banking company. In the case of foreign banks setting up office of business in India, they are required to bring in a minimum of ten million US dollars to India as Capital. (A million is equal to ten lakhs). The minimum capital required to start a Local Area Bank is fixed at Rs. 5.00 crores.

- Prohibition of charge on unpaid capital: Section 14 - No banking company shall create any charge upon its unpaid capital, and any such charge if created, shall be invalid.

- Limiting the payment of dividends : Section 15 (Preliminary expenses, Brokerage and Commission on issue of shares)

- Transfer to Reserve Fund: Section 17 -Under Section 17, Banking companies incorporated in India are obligated to transfer to the reserve fund a sum equivalent to not less than 20% of the profit each year, unless the amount in such fund together with the amount in the share premium account is more than or equal to its paid-up capital.

- Maintenance of cash reserve by non-scheduled banks: Section 18 According to Section 18, every banking company not being a scheduled bank (i.e., a non-scheduled bank) has to maintain in India by way of cash reserve with itself or in current account opened with the Reserve Bank or the State Bank of India or any notified Bank or partly in cash with itself and partly in such account or accounts a sum equivalent to at least 3% of its total time and demand liabilities.

- Restrictions on loans and advances: Sections 20 & 21

Section 20 lays down the restrictions on banking companies from entering into any commitment from granting any loan to any of its director or to any firm in which a director is interested or to any individual or whom a director stands as a guarantor. Further the banking companies are prohibited from granting loans or advances on the security of its own shares.

Under Section 21, the RBI has been empowered to determine the policy to be followed by the banks in relation to advances. Thus, RBI gives directions to banking companies on the following matters:

(i) The purposes for which an advance may or may not be granted

(ii) The margins to be maintained in case of secured advances

(iii) The rate of interest charged on advances, other financial accommodation and commission on guarantees

(iv) The maximum amount of advance or other financial accommodation that a bank may make to or guarantee that it may issue for, a single party, having regard to the paid-up capital, reserves and deposits of the concerned bank.

- The Reserve Bank may cancel a license granted to a banking company under this section:
- (i) If the company ceases to carry on banking business in India; or
- *(ii)* If the company at any time fails to comply with any of the conditions imposed upon it; or*
- *(iii)* Any banking company aggrieved by the decision of the Reserve Bank cancelling a license under this section may, within thirty days from the date on which such decision is communicated to it, appeal to the Central Government. The decision of the Central Government shall be final.
- Thus, every banking company which likes to start banking business in India must obtain license from RBI.
- **Control on the opening of new business: Section 23 -**cording to this section, the RBI has been empowered to control the opening of new and transfer of existing places of business of banking companies. As such, no banking company shall open a new place of business in India or outside India and change the place without obtaining the prior permission of the RBI.

- No permission is required for opening a branch within the same city, town or village and for opening a temporary place of business for a maximum period of one month within a city, where the banking company already has a place of business for the purpose of providing banking facilities to the public on the occasion of an exhibition, a conference, a mela, etc.

- **Maintenance of a percentage of liquid assets (SLR): Section 24**

Under this section, every banking company shall maintain in India in liquid assets for an amount not less than 25% of the total of its time and demand liabilities at the close of business on any day. The liquid assets include cash, gold or unencumbered approved securities and they are valued at a price not exceeding the current market price.

- **Maintenance of Assets in India: Section 25**

Section 25 requires for the maintenance of assets equivalent to at least 75% of its demand and time liabilities in India, at the close of business of the last Friday of every quarter.

- **Submission of Returns of unclaimed Deposits: Section 26**

According to this section, every banking company shall submit a return in the prescribed form and manner to the RBI, giving particulars, regarding unoperated accounts in India for 10 years. This return is to be submitted within 30 days after the close of each calendar year.

In the case of fixed deposits, the 10 years period is counted from the date of expiry of such fixed period. RRBs are however required to forward such returns to NABARD

- **Submission of Return, Forms, etc., to RBI: Section 27**

Under this section, every banking company shall submit to be RBI a return in the prescribed form (form 13) and manner showing its assets and liabilities in India on the last Friday of every month, (if that Friday is a public holiday under the negotiable instruments Act, 1881, on the preceding working day.)

Besides, the RBI may at any time direct a banking company to furnish the statements and information relating to the business or affairs of the banking company within the specified period mentioned therein.

Such directions may be issued when the RBI considers it is necessary or expedient to obtain for the purpose of the Act. And the RBI may call for information every half year, regarding the investments of banking company and the classifications of advance given in respect of industry, commerce and agriculture.

- **Powers to Publish Information: Section 28**

Under this section, the RBI is authorized to publish in the public interest any information obtained under the Banking Regulation Act. The information is published in the consolidated form as the RBI may think fit.

- **Maintenance of Accounts and Balance Sheets: Section 29**

This section provides for the preparation of Balance Sheet and Profit & Loss Account as on the last working day of the year in respect of all business transacted by a banking company incorporated in India and in respect of all business transacted through its branches in India by a banking company incorporated outside India. It is prepared in the forms set out in the Third Schedule.

The central government after giving not less than three months notice of its intention so to do by a notification in the official gazette, may from time to time by a like notification amend the forms set out in the Third Schedule.

In the view of the fact that in the opinion of experts, as well as the Banking enquiry committee, that form “f ” required to be used by every company in preparing its balance sheet.

- **Inspection of books of accounts: Section 35**
- This Section was incorporated with a view to safeguard the interest of shareholders and depositors of banking companies, as a result of which bank directors and managers are likely to be cautious in employing the funds of their institutions.
- This section provides wide powers to RBI to cause an inspection of any banking company and its books and accounts.
- **Giving directions to Banking Companies: Section 35A**

Under Section on 35A, the Reserve Bank may caution or prohibit banking companies generally or any banking company in particular against entering into certain types of operations.

Prior approval from RBI for appointment of Managing Director, etc. Section 35 AB

According to this section, prior approval of RBI should be obtained for the appointment, re-appointment, remuneration and removal of the chairman or a director of a banking company. And for the amendments of provisions in the Memorandum or Articles or Resolutions of a General Meeting or Board of Directors, the prior approval of RBI is necessary.

Removal of managerial and any other persons from office: Section 36AA and Section 36AB

Under these sections, the RBI has power to remove managerial and other persons from office and to appoint additional directors.

- **Winding up of Banking Companies: Section 38 to 44**
- Sections 38 to 44 of the Act lay down the provisions for winding up of a banking company. The RBI may apply for the winding up of a banking company if,
- (i) It fails to comply with the requirements as to minimum Paid-up capital and reserves as laid down in Section 11, or
- (ii) Is disentitled to carry on the banking business for want of license under Section 22, or
- (iii) It has been prohibited from receiving fresh deposits by the Central Government or the Reserve Bank, or

- (iv) It has failed to comply with any requirement of the Act, and continues to do so even after the Reserve Bank calls upon it to do so,
- (v) The Reserve Bank thinks that a compromise or arrangement sanctioned by the court cannot be worked satisfactorily, or
- (vi) The Reserve Bank thinks that according to the returns furnished by the company it is unable to pay its debts or its continuance is prejudicial to the interests of the depositors.
- The banking company cannot be voluntarily wound up unless the Reserve Bank certifies that it is able to pay its debts in full.
- **Amalgamation of Banking Companies: Section 44A**

The procedures for amalgamation of banking companies are given under this section. As per this section the scheme of amalgamation (i.e., the terms and conditions of amalgamation) is to be approved by a majority – 2/3 of the total voting ratios – of the shareholders in a general meeting.

The unwilling shareholders are entitled to receive the value of their shares as may be determined by the RBI. The RBI has to sanction the scheme of amalgamation after the shareholders' approval.

The assets and liabilities are transferred to the acquiring bank according to the directions of RBI mentioned in the sanction order. The RBI issues order for the dissolution of the first bank on a specified date.

Money Laundering – Introduction

- Banks were advised to follow certain customer identification procedure for opening of accounts and monitoring transactions of a suspicious nature.
- The Prevention of Money Laundering Act (PMLA), 2002 is an Act of the Parliament of India enacted in January, 2003. The Act has come into force w.e.f. 1st July, 2005.
- KYC Guideline revisited on recommendations made by the Financial Action Task Force (FATF) on Anti Money Laundering (AML) standards and on Combating the Financing of Terrorism (CFT).
- PMLA (Amendment) Act, 2012 as passed by Lok Sabha on 29/11/2012 has come into force w.e.f. 15th February 2013.

Definition as per PMLA 2002

- Sec.3 of PML Act defines 'money laundering' as: "whosoever directly or indirectly attempts to indulge or knowingly assists or knowingly is a party or is actually involved in any process or activity connected with the proceeds of crime and projecting it as untainted property shall be guilty of the offence of money-laundering".

Objective of Anti-Money Laundering Policy

- To prevent banks from being used, intentionally or unintentionally, by criminals for Money Laundering activities or terrorist activities.
- To enable banks to know/ understand their customer and their financial dealings better.
- To put in place a proper control mechanism for detecting and reporting suspicious transaction.
- It will also enhance fraud Prevention.
- To ensure compliance with guidelines issued by the regulators including FIU-IND & RBI.

Obligations Under PMLA 2002

- Appointment of Principal Officers and designated Director,
- Maintaining record of prescribed transactions,
- Furnishing information of transaction to the specified authority,
- Verifying & maintaining record of the identity of its clients,
- Preserving records for 5 years from the date of each transactions between bank & clients or for 5 years after business relationship ended.

Punishment for Money Laundering

- Punishment for non-adherence of the Act would be rigorous imprisonment for not less than 3 years but up to 7 years.
- But in case of offences done under Narcotic Drugs and Psychotropic Substance Act 1985 the maximum punishment may extend to 10 years.

Money Laundering Risks

Bank is exposed to the following risks:

- Reputational Risk: Risk of loss due to severe impact on bank's reputation which is most valuable asset of the organization.

- Compliance Risk: Risk of loss due to failure to comply with key regulations governing the bank's operations.
- Operational Risk: The risk of direct or indirect loss resulting from inadequate or failed internal processes, people and systems or from external events.
- Legal Risk: Risk of loss due to any legal action the bank or its staff may face due to failure to comply with the law resulting in adverse judgments, unenforceable contracts, fines and penalties, generating losses, increased expenses for an institutions or even closure of such institutions.

Way of Money Laundering

- Money laundering generally refers to 'washing' of the proceeds or profits generated from:

(i) Drug trafficking

(ii) Arms, antique, gold smuggling

(iii) Prostitution rings

(iv) Financial frauds

(v) Corruption, or

(vi) Illegal sale of wild life products and other specified predicate offences.

Indicators of Money Laundering

- Turn over in dormant account;
- Receipt/payment of large sums of cash;
- Reluctance to provide normal information;
- Depositing high value third party cheques;
- Large credits from abroad;
- Employees leading lavish life style;
- Hawala Transaction.

Combating the financing of Terrorism (CFT) measures

- Money to fund terrorist activities moves through the global financial system via wire transfers and in and out of personal and business accounts.

- It can sit in the accounts of illegitimate charities and be laundered through buying and selling securities and other commodities, or purchasing and cashing out insurance policies.
- Before opening of the new account branches should ensure the name is not listed in:- I. Al-Qaida sanction list II. 1988 sanction list N.B.:- Banks are regularly putting in KRISH MENU updated list.

KYC Standards

The key elements of policy are as under :

- CAP (Customer Acceptance Policy)
- Risk management
- CIP (Customer Identification Procedure)
- Monitoring of transactions

Customer Acceptance Policy not to Open accounts of following persons

- Anonymous /Fictitious/Benami Names and with Criminal Background.
- Branch should prepare a profile for each new customer based on risk categorization Risk categorization should be reviewed once in a 6 months.
- Occupation code field made Mandatory in the system.
- No account should be opened where bank is unable to apply due diligence measures. Bank can close those a/c where customer is not co-operating in submission of documents (decided by DZM or AGM after giving notice to customer).

Partial Freezing /Closure of NON-KYC compliance account

In the case of non-compliance of KYC guideline account, RBI advised the bank to take the following steps:

- Initially, a notice of 3 moths should be given for KYC compliance,
- It should be followed reminder for further 3 months,
- Thereafter, Partial freeze the debit and allowing credit only,
- If partial freeze continue for 6 months and accounts are still non- KYC complaint, both credit and debit freeze and may be close the account.

- Closure of account shall be approved by Branch Manager.
- Reason for partial freeze and closure should be communicated to account holder.

Customer Acceptance Policy

- Bank have introduced a Customer Profile Sheet (CPS) which is required to be obtained at account opening time. Indicative parameters of CPS are:

a) Constitution: Individual, Proprietorship, Partnership, Society, public/private limited company, Trust etc,

b) Product Subscription: Salary A/c, Business, NRI etc

c) Nationality

d) Social status

e) Financial status, Volume of turn over etc

f) Nature of business

g) Activity engaged

h) Clients and their geographical location

Customer Risk Rating/Categorization

- Low Risk category: (Full KYC in10 years)

1. Salaried employed whose salary structure is well defined, Pensioners, benefit recipients.

2.People belonging to lower economic strata of society showing small balances.

3.Govt. department and govt. owned companies, Regulators, Statutory Bodies etc.

4.Customer with a long term and active business relationship.

5. Customer other than High & Medium risk.

- Medium Risk Customer: (Full KYC in 8 years)

1. NBFC,
2. Builders,
3. Stock Brokers.

- High Risk Customer: (Full KYC in2years)

1. Non resident customer,
2. HNI, Non-face to face customer,
3. Trust, Charities, NGOs, Sleeping Partner firms, Investment Company,
4. Donation receiving organization, Religious institution,
5. Shopping malls, Jewelers, Petrol pump, Liquor stores,
6. Antique dealers, Arms dealer, Agent, Brokers, Bullion dealers,
7. Politically Exposed Persons of foreign origin,
8. Customer with dubious reputation etc,
9. Companies having close family share holding etc.
10. Person living in High Risk Countries

Officially Valid KYC Document

- Officially valid KYC document":- The below mentioned six officially valid documents will serve the purpose for both identification of customer and also the address proof of customer.

1.Passport (within validity),

2.Driving License (within validity),

3.PAN Card (Only Identity proof),

4.Voter's Identity Card,

5.Job Card issued by NREGA,

6.Letter issued by UIDAI – Aadhaar number .NB:- If the customer is providing the Passport, the full detail of the passport to be captured mandatorily in the Finacle system/CUMM along with customer nationality of all NRI/PIO or Domestic customer.

FRAUD IN THE BANKING SECTOR – Introduction

- Banks are an essential part of the Indian economy.
- While the primary responsibility for preventing frauds lies with banks themselves.

- Banks are dealing with public's money and hence it is imperative that employees should exercise due care and diligence in handling the transactions in banks.

The RBI has been advising banks from time to time about the major fraud prone areas and the safeguards necessary for prevention of frauds

Definition of fraud

- Fraud can loosely be defined as "any behaviour by which one person intends to gain a dishonest advantage over another" fraud, under section 17 of the Indian contract act, 1872,
- RBI not defined the term "fraud" in its guidelines on frauds which reads as under.

"A deliberate act of omission or commission by any person, carried out in the course of a banking transaction or in the books of accounts maintained manually or under computer system in banks, resulting into wrongful gain to any person for A temporary period or otherwise, with or without any monetary loss to the bank".

Types of Frauds

- **Account opening fraud**: this involves a deposit and cashing of fraudulent cheques.
- **Cheque kiting**: is a method where by a depositor utilizes the time required for cheques to dear to obtain an unauthorized loan without any interest charge.
- **Cheque fraud**: most common cases of this kind of fraud are through stolen cheques and forged signatures.
- **Counterfeit securities:** documents, securities, bonds and certificate could be forged, duplicated, adjusted or altered and presented for loan collection.
- **Computer fraud**: hacking, tampering with a diskette to gain access to unauthorized areas and give credit to an account for which the funds were not originally intended.
- **Loan fraud**: when funds are lent to a non-borrowing customer or a borrowing customer that has exceeded his credit limit.
- **Money laundering fraud**: this is a means to conceal the existence, source or use of illegal obtained money by converting the cash into untraceable transactions in banks.
- **Money transfer fraud:** alteration of a genuine Funds transfer request. e.g Mail, telephone, electronic process, telex.
- **Telex Fraud**: The messages that are passed through telex in form of codes could be altered to divert the funds to another account

- **Letters of Credit**: Most common in international trading, these are instruments used across borders ads can be forged, altered, adjusted and take longer to identify.
- **Advanced Fees Fraud**: Popularly known as ‘419’, advanced fees fraud may involve agent with an offer of a business proposition which would lead to access often for a long term.

Category of frauds

Technology related

- The Technology related fraud around 65% 10 of the total fraud cases reported by banks. (covering frauds committed through /at internet banking channel, ATMs and other alternate payment channels like credit/debit/prepaid cards)
- Banks are adopt newer service delivery platforms like mobile, internet and social media, for enhanced efficiency and cost-cutting.
- Banks’ customers have become tech savvy and started using online banking services and products. .

KYC related (mainly in deposit accounts)

- KYC (Know Your Customer) is a framework for banks which enables them to know / understand the customers and their financial dealings to be able to serve them better.
- RBI has advised banks to make the KYC procedures mandatory while opening and operating the accounts.
- Issued the KYC guidelines under section 35 (A) of the banking regulation act, 1949.
- For this purpose, the fraudsters generally use deposit accounts in banks with lax KYC drills.
- Therefore, customers to guard against such temptations for easy money but should also ensure that deposit accounts maintained with them are fully KYC compliant.

Advances related

- Frauds related to the advances portfolio accounts for the largest Share of the total amount involved in frauds in the banking sector. (Involving amount of Rs. 50 crore and above)
- Another point that public sector banks account for a substantial chunk of the total amount involved in such cases.

- Declaration of frauds by various banks in cases of consortium/ multiple financing we have on occasions observed more than 12– 15 months lag in declaration.
- The large value advance related frauds, which pose a significant challenge to all stakeholders, are mainly concentrated in the public sector banks. Majority of the credit related frauds are on account of deficient appraisal system, poor post disbursement supervision and inadequate.
- Reserve bank has also advised banks to audit periodically so that cases of multiple financing may be detected in the initial stages itself.

Guidelines for Reporting Frauds to POLICE/CBI

Private Sector Banks/Foreign banks (operating in India)

- While reporting the frauds, banks are required to ensure that, besides the necessity of recovering the amount expeditiously, the guilty persons do not get unpunished.
- Cases that are required to be referred to State Police include:-

a) Cases of fraud involving an amount of Rs. 1.00 lakh and above committed by outsiders on their own and/or with the connivance of bank staff/officers.

b) Cases of fraud involving amount exceeding Rs. 10,000/-committed by bank employees.

c) Fraud cases involving amounts of Rs 1.00 crore and above should also be reported to the Serious Fraud Investigation Office (SFIO), GOI,

Public Sector Banks

- Cases to be referred to CBI

a) Cases of fraud involving amount of Rs. 1.00 crore and above upto Rs. 7.50 crore:-

• Where staff involvement is prima facie evident –

CBI (Anti Corruption Branch).

• Where staff involvement is prima facie not evident- CBI (Economic Offences Wing)

a) All cases involving more than Rs.7.50 crore - Banking Security and Fraud Cell of the respective centres, which is specialized cell of the Economic Offences Wing of the CBI for major bank fraud cases.

b) Cases to be referred to Local Police

Cash Reserve Ratio (CRR) RBI meaning, CRR rate: The Cash Reserve Ratio in India is decided by RBI's Monetary Policy Committee in the periodic Monetary and Credit Policy. The Reserve Bank of India takes stock of the CRR in every monetary policy review, which, at present, is conducted every six weeks. CRR is one of the major weapons in the RBI's arsenal that allows it to maintain a desired level of inflation, control the money supply, and also liquidity in the economy. The lower the CRR, the higher liquidity with the banks, which in turn goes into investment and lending and vice-versa. Higher CRR can also negatively impact the economy as lesser availability of loanable funds, in turn, slows down investment. It thereby reduces the supply of money in the economy.

What is CRR or Cash Reserve Ratio?

The Reserve Bank of India or RBI mandates that banks store a proportion of their deposits in the form of cash so that the same can be given to the bank's customers if the need arises. The percentage of cash required to be kept in reserves, vis-a-vis a bank's total deposits, is called the Cash Reserve Ratio. The cash reserve is either stored in the bank's vault or is sent to the RBI. Banks do not get any interest on the money that is with the RBI under the CRR requirements.

How is Cash Reserve Ratio calculated? CRR formula:

If the current CRR rate is 4%, a bank is required to store 4% of the total NDTL or the Net Demand and Time Liabilities in the form of cash. The bank cannot use this money for investment or lending.

Objectives of Cash Reserve Ratio

There are two primary purposes of the Cash Reserve Ratio:

- Since a part of the bank's deposits is with the Reserve Bank of India, it ensures the security of the amount. It makes it readily available when customers want their deposits back.
- Also, CRR helps in keeping inflation under control. At the time of high inflation in the economy, RBI increases the CRR, so that banks need to keep more money in reserves so that they have less money to lend further.

How does Cash Reserve Ratio help in times of high inflation?

At the time of high inflation, the government needs to ensure that excess money is not available in the economy. To that extent, RBI increases the Cash Reserve Ratio, and the amount of money that is available with the banks reduces. This curbs excess flow of money in the economy. When the government needs to pump funds into the system, it lowers the CRR rate, which in turn, helps the banks provide loans to a large number of businesses and industries for investment purposes. Lower CRR also boosts the growth rate of the economy.

Statutory Liquidity Ratio -Definition

Statutory Liquidity Ratio or SLR is the minimum percentage of deposits that a commercial bank has to maintain in the form of liquid cash, gold or other securities. It is basically the reserve requirement that banks are expected to keep before offering credit to customers. The SLR is fixed by the RBI and is a form of control over the credit growth in India.

The government uses the SLR to regulate inflation and fuel growth. Increasing the SLR will control inflation in the economy while decreasing the statutory liquidity rate will cause growth in the economy. The SLR was prescribed by Section 24 (2A) of Banking Regulation Act, 1949.

Why is the SLR fixed?

- To check the expansion of bank credit.
- To ensure the solvency of commercial banks.
- To compel banks to invest in government securities like bonds.
- To fuel growth and demand; this is done by decreasing the SLR so that there is more liquidity with the commercial banks.

If a bank fails to maintain the prescribed SLR, it is liable to pay a penalty to the Reserve Bank of India. The defaulter bank has to pay a penalty of 3% above the bank rate on the deficient amount for that particular day.

SLR plays a very important role in fixing the minimum rate at which a bank can lend money to its customers. This minimum amount is called the base rate. This helps in building transparency between the Reserve Bank of India and other public dealing banks.

The Reserve Bank of India is the body which sets the SLR. The Reserve Bank of India increases the SLR at the time of inflation to control bank credit. At the time of recession, RBI decreases the SLR to increase bank credit.

Asset Liability Management - Meaning

Asset Liability Management (ALM) can be defined as a mechanism to address the risk faced by a bank due to a mismatch between assets and liabilities either due to **liquidity** or changes in interest rates. **Liquidity** is an institution's ability to meet its liabilities either by borrowing or converting assets.

Objectives of Asset/Liability Management

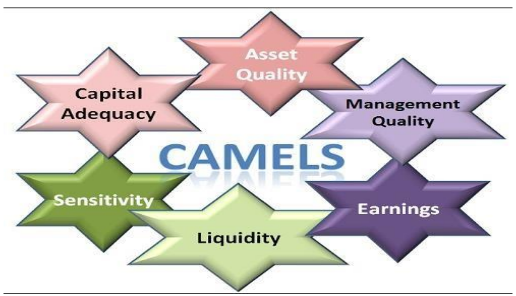
The primary objective of the Asset/Liability Management (ALM) Policy is to maximize earnings and return on assets within acceptable levels of **risk**: Interest Rate - impact on earnings and net worth from potential short- and long-term changes in interest rates.

Camels Rating – Overview

The concept was initially adopted in 1979 by the Federal Financial Institutions Examination Council (FFIEC) under the name Uniform Financial Institutions **Rating System** (UFIRS).

- **Definition: CAMELS Rating** is the rating system wherein the bank regulators or examiners (generally the officers trained by RBI), evaluates an overall performance of the banks and determine their strengths and weaknesses.
- CAMELS Rating is based on the financial statements of the banks, Viz. Profit and loss account, balance sheet and on-site examination by the bank regulators.
- In this Rating system, the officers rate the banks on a scale from 1 to 5, where **1** is the **best** and **5** is the **worst**. The parameters on the basis of which the ratings are done are represented by an acronym **"CAMELS".**

CAMELS is an international **rating system** used by regulatory banking authorities to rate financial institutions, according to the six factors represented by its acronym. The **CAMELS** acronym stands for "Capital adequacy, Asset quality, Management, Earnings, Liquidity, and Sensitivity."



Camels Rating Framework

Capital Adequacy

- Capital adequacy focusses on the total position of ban capital.

- It assures the depositors that they are protected from the potential shocks of losses that a bank incurs.

- Financial managers maintain company's adequate level of capitalization by following it. It is the key parameter of maintaining adequate levels of capitalization.

Asset Quality

- Asset quality determines the robustness of financial institutions against loss of value in the assets.
- All commercial banks show the concentration of loans and advances in total assets.
- The high concentration of loan and advances indicates vulnerability of assets to credit risk, especially since the portion of non-performing assets is significant.

Management Soundness

- It is also depends on compliance with set norm, planning ability; react to changing situation, technical competence, leadership and administrative quality.
- A sound management is the most important pre-requisite for the strength and growth of any financial institution.

Earnings and profitability

-It is the prime sources of increasing capital of any financial institution.

-Strong earnings and profitability profile of a bank reflect its ability to support present and future operations.

-Increased earning ensure adequate capital and adequate capital can absorb all losses and give shareholder adequate dividends.

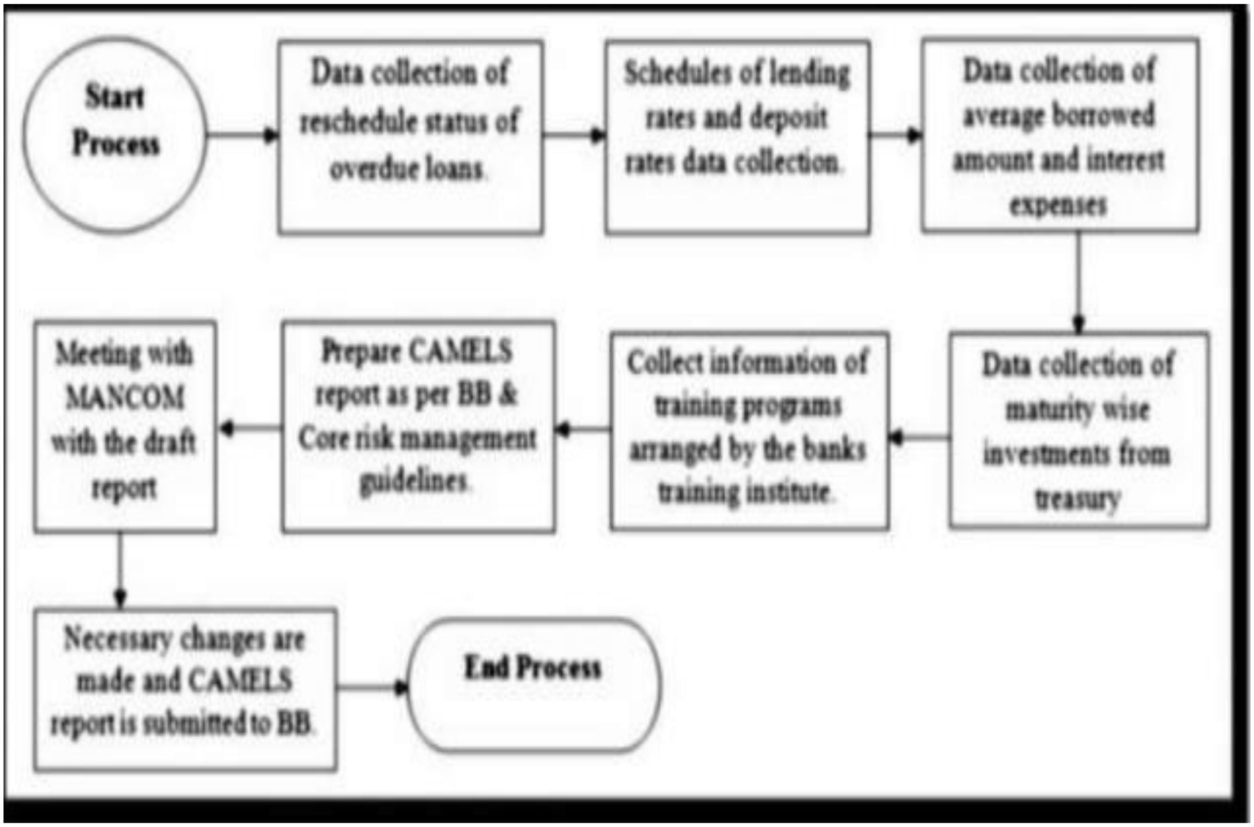
Liquidity

- An adequate liquidity position refers to a situation, where an institution can obtain sufficient funds, either by increasing liabilities or by converting its assets quickly at a reasonable cost.
- It accesses in terms of asset and liability management.
- Liquidity indicators measured as percentage of demand and time liabilities (excluding interbank items) of the banks.
- It means that the percentage of demand and time liabilities gets a bank as per its liquid assets.

Sensitivity to Market Risk

-The sensitivity to market risk is evaluated from changes in market prices, notably interest rates; exchange rates, commodity prices and equity prices adversely affect a bank's earnings and capital.

Camels Reporting - Process



- **What are Basel norms?**

Basel norms or Basel accords are the **international banking regulations issued by the Basel Committee on Banking Supervision.**

The Basel norms is an effort to coordinate banking regulations across the globe, with the **goal of strengthening the international banking system.**

It is the **set of the agreement by the Basel committee of Banking Supervision** which focuses on the risks to banks and the financial system.

What is the Basel committee on Banking Supervision?

- The **Basel Committee on Banking Supervision (BCBS)** is the **primary global standard setter for the prudential regulation of banks** and provides a forum for regular cooperation on banking supervisory matters for the central banks of different countries.

- It was **established by the Central Bank governors of the Group of Ten countries in 1974.**
- The committee expanded its membership in 2009 and then again in 2014. The BCBS **now has 45 members from 28 Jurisdictions,** consisting of Central Banks and authorities with responsibility of banking regulation.
- It provides a forum for regular cooperation on banking supervisory matters.
- Its objective is to enhance understanding of key supervisory issues and **improve the quality of banking supervision worldwide.**

Why these norms?

- **Banks lend to different types of borrowers and each carries its own risk.**
- They lend the deposits of the public as well as money raised from the market i.e, equity and debt.
- This **exposes the bank to a variety of risks of default** and as a result they fall at times.
- Therefore, Banks have to keep aside a certain percentage of capital as security against the risk of non – recovery.
- The Basel committee has produced norms called Basel Norms for Banking to tackle this risk.

Why the name Basel?

- Basel is a **city in Switzerland.**
- It is the **headquarters of the Bureau of International Settlement (BIS)**, which fosters cooperation among central banks with a common goal of financial stability and common standards of banking regulations.
- It was founded in 1930.
- The **Basel Committee on Banking Supervision is housed in the BIS offices in Basel, Switzerland.**

What are these norms?

The Basel Committee has issued three sets of regulations which are known as Basel-I, II, and III.

Basel-I

- It was introduced in 1988.

- It **focused almost entirely on credit risk.**
- Credit risk is the possibility of a loss resulting from a borrower's failure to repay a loan or meet contractual obligations. Traditionally, it refers to the risk that a lender may not receive the owed principal and interest.
- It defined capital and structure of risk weights for banks.
- The minimum capital requirement was fixed at 8% of risk weighted assets (RWA).
- RWA means assets with different risk profiles.
- For example, an asset backed by collateral would carry lesser risks as compared to personal loans, which have no collateral.
- **India adopted Basel-I guidelines in 1999.**

Basel-II In 2004, Basel II guidelines were published by BCBS.

- These were the refined and reformed versions of Basel I accord.
- The guidelines were **based on three parameters, which the committee calls it as pillars.**
  - **Capital Adequacy Requirements:** Banks should maintain a minimum capital adequacy requirement of 8% of risk assets
  - **Supervisory Review:** According to this, banks were needed to develop and use better risk management techniques in monitoring and managing all the three types of risks that a bank faces, viz. credit, market and operational risks.
  - **Market Discipline:** This needs increased disclosure requirements. Banks need to mandatorily disclose their CAR, risk exposure, etc to the central bank.
- **Basel II norms in India and overseas are yet to be fully implemented though India follows these norms.**

Basel III In 2010, **Basel III** guidelines were released.

- These guidelines were introduced in response to the financial crisis of 2008.
- A need was felt to further strengthen the system as banks in the developed economies were under-capitalized, over-leveraged and had a greater reliance on short-term funding.
- It was also felt that the quantity and quality of capital under Basel II were deemed insufficient to contain any further risk.

- **Securitisation and Reconstruction of Financial Assets and Enforcement of Security Interest (Sarfaesi) Act** of 2002.
- Banks utilize Sarfaesi Act as an **effective tool for bad loans (Non Performing Asset) recovery.**

SARFAESI ACT

- The Sarfaesi Act is **effective only against secured loans** where banks can enforce the underlying security.
- Following are the main objectives of the Sarfaesi Act.
  - Provides the legal framework for securitization activities in India.
  - It gives the procedures for the transfer of NPAs to asset reconstruction companies for the reconstruction of the assets.
  - Enforces the security interest without Court's intervention.
  - Gives powers to banks and financial institutions to take over the immovable property that is pledged to enforce the recovery of debt.
  - Major feature of Sarfaesi is that it **promotes the setting up of asset reconstruction companies (ARCs) and asset securitization companies (SCs)** to deal with NPAs accumulated with the banks and financial institutions.
  - The Act provides three alternative methods for recovery of non-performing assets, namely:
    - **Securitisation**

      Securitization is the practice of pooling together various types of debt instruments (assets) such as mortgages and other consumer loans and selling them as bonds to investors.
    - **Asset Reconstruction**

      Asset reconstruction is the activity of converting a bad or non-performing asset into performing asset with the help of Asset reconstruction companies
    - **Enforcement of Security without the intervention of the Court.**
      If the borrower defaults, the bank may enforce security interests by:

- Take possession of the security;
- Sale or lease or assign the right over the security;
- Appoint Manager to manage the security;
- Ask any debtors of the borrower to pay any sum due to the borrower.

Rs. 1.00 Lakh and above involving outsiders (Private parties and bank staff	Regional Head of the bank to State CID/Economic Offences Wing of State concerned
Below Rs. 1.00 Lakh but below Rs. 10,000/-	Local Police Station by the branch
Below Rs. 10,000/- involving bank officials	Reported to Regional Head of the bank to decide on further course of action.
Fraudulent encashment of DD/TTs/Pay orders/ Cheques/ DWs, etc.	Local Police concerned
Frauds involving forged instruments	Paying banker to Local Police
Collection of genuine instrument, but collected frequently by a person who is not the owner	Collecting bank to Local Police concerned
Payment of uncleared instrument which found to be fake/forged and returned by the paying bank	Collecting Bank to Local Police
Collection/payment of altered/fake cheque involving 2 or more branches of the same bank	Branch where the cheque was encashed to the Local Police

Reporting cases of theft, burglary, dacoity and bank robberies

- Occurrence of any bank robberies, dacoities, thefts and burglaries are required to be reported immediately by Fax/e-mail to RBI, Department of Banking Supervision, Central Office and Regional Office, Security Adviser, and Ministry of Finance of Economic Affairs (Banking Division), GOI with details of modus operandi and other information as required in FMR-4.

- Banks are also required to submit a quarterly consolidated statement (FMR-4) to RBI Central Office/RO within 15 days of the end of the quarter it relates.

BANKING OMBUDSMAN

- An official appointed to investigate individual's complaint against maladministration especially that of public authorities.

- The Banking Ombudsman Scheme enables an expeditious and inexpensive forum to bank customers for resolution of complaints relating to certain services rendered by banks.

JURISDICATION OF BANKING OMBUDSMAN

- Applies to whole India (including Jammu and Kashmir)
- Banking Ombudsman have jurisdiction over

- All commercial banks (scheduled and non-scheduled, public and private)
- Regional Rural Banks
- Scheduled primary co-operative banks
- NBFC

APPOINTMENT AND TENURE

- The Reserve Bank may appoint one or more of its officers in the rank of Chief General Manager or General Manager to be known as the banking ombudsmen
- They carry out the functions entrusted to them by or under the scheme
- This appointment may be made for a period not exceeding three years at a time

QUALIFICATION

The Banking Ombudsman shall be a person of repute experience in the field of

• Law

• Banking

• Financial services

• Public administration or

• Management sectors

• If such person is a civil servant he should be in the rank of joint secretary or above in the Government of India and

• Incase of such person being from banking sector, he should had the experience of working as a whole time Director in a public sector or equivalent position

- **Territorial Jurisdiction and Location of Office** • The Reserve Bank shall specify the territorial limits to which the authority of each of the banking ombudsman shall extend • The office of the banking ombudsman will be located at such places as may be specified by the Reserve Bank
- **Sittings** The banking ombudsman may hold sittings at such places within his area of jurisdiction as may be considered necessary and proper by him, in respect of a complaint or reference before him
- **Secretariat**

• The Reserve Bank shall depute such number of itsofficers and other staff to the office of the bankingombudsman as considered necessary to function as the secretariat of the banking ombudsman.

• The cost of the secretariat will be borne by the Reserve Bank.

GENERAL POWERS OF BANKING OMBUDSMAN

- To receive complaints relating to banking services
- To consider such complaints relating to the deficiencies in the banking and other services and facilitate their satisfaction or settlement by agreement through conciliation and mediation between the bank and the aggrieved parties or by passing an award in accordance with the scheme

POWERS TO CALL FOR INFORMATION

- Banking Ombudsman may require the bank against whom the complaint is made or any other bank concerned with the complaint to provide any information or furnish certified copy of any document relating to the complaint which is or alleged to be in its possession
- The Banking Ombudsman shall maintain confidentiality of such information

GROUNDS ON WHICH THE BANKING OMBUDSMAN CAN RECEIVE AND CONSIDERCOMPLAINTS DEFICIENCY IN SERVICES
(including internet banking)

- Non-payment or inordinate delay in the payment or collection of cheques, drafts, bills etc
- Delay in payment of inward remittances
- Delay / failure of issuing drafts / pay orders / bankers cheque / banking facility
- Delay and failure in providing necessary banking services and products like debit cards,
- Complaints of accounts operated by NRI
- Refusal in opening the deposit account and levying additional charges for the products without informing the customer
- Non-Adherence to the RBI guidelines in the matter of credit and debit cards
- Delay in disbursing of pension
- Refusal / delay in accepting payment towards taxes
- Delay / refusal in servicing or redemption of government securities

- Refusal / delay in closing of accounts
- Non-adherence to the fair practices code as adopted by the bank or non-adherence to the provisions of the Code of Banks Commitments to Customers issued by Banking Codes and Standards Board of India and as adopted by the bank
- Non-observance of RBI guidelines on engagement of recovery agents by bank
- Any other matter relating to the violation of the directives issued by the RBI in relation to banking or other services
- Non-adherence to the fair practices code as adopted by the bank or non-adherence to the provisions of the Code of Bank Commitments to Customers issued by Banking Codes and Standards Board of India and as adopted by the bank
- Non-observance of RBI guidelines on engagement of recovery agents by bank
- Any other matter relating to the violation of the directives issued by the RBI in relation to banking or other services

DEFICIENCY IN SERVICES

(loans and advances

- Non – compliance of interest rates as per guidelines from RBI
- Delays in sanction, disbursement or non- observance of prescribed time schedule for disposal of loan applications
- Non-acceptance of loan application without furnishing valid reasons
- Non-observance of any other directions or instructions of the RBI from time to time.

REDRESSAL OF GRIEVANCES

- PROCEDURE FOR REDRESSAL OF GRIEVANCE

• Any person who has a grievance against a bank on any one or more of the grounds mentioned in Clause 8 of the Scheme may, himself or through his authorized representative (other than an advocate), make a complaint to the Banking Ombudsman within whose jurisdiction the branch or office of the bank complained against is located

• The complainant shall file along with the complaint, copies of the documents, if any, which he proposes to rely upon.

A complaint made through electronic means shall also be accepted by the Banking Ombudsman.

- The Banking Ombudsman shall also entertain complaints covered by this Scheme received by Central Government or Reserve Bank and forwarded to him for disposal.
- The application generates unique complaint ID
- Automatic acknowledgement generated on tracking of complaints
- RBI and Finance ministry can also monitor the status of the complaints

No Complaint To Banking Shall Lie Unless

- The complainant had, before making a complaint to the Banking Ombudsman, made a written representation to the bank and the bank had rejected the complaint.
- The complainant had not received any reply within a period of one month after the bank received his representation.

The complaint is made not later than one year after the complainant has received the reply of the bank to his representation or, where no reply is received

SETTLEMENT OF COMPLAINT BY AGREEMENT

- As soon as it may be practicable to do, the Banking Ombudsman shall send a copy of the complaint to the branch or office of the bank named in the complaint

For the purpose of promoting a settlement of the complaint, the Banking Ombudsman may follow such procedure as he may consider just and proper

AWARDS BY THE BANKING OMBUDSMAN

- The Banking Ombudsman shall take into account aspect while passing Award.
- The Award passed shall contain the direction/s, if any, to the bank for specific performance of its obligations and in addition to or otherwise, the amount, if any, to be paid by the bank to the complainant by way of compensation for any loss suffered by the complainant.
- The Banking Ombudsman shall not have the power to pass an award directing payment of an amount which is more than the actual loss suffered by the complainant.

- In the case of complaints, arising out of credit card operations, the Banking Ombudsman may also award compensation not exceeding Rs 1 lakh to the Complainant

- A copy of the Award shall be sent to the complainant and the bank

- An award shall lapse and be of no effect unless the complainant furnishes to the bank concerned within a period of 30 days from the date of receipt of copy of the Award

REJECTION OF COMPLAINTS

- The Banking Ombudsman may reject a complaint at any stage if it appears to him that the complaint made is:

  • Not on the grounds of complaint referred to in clause 8 or

  • Beyond the pecuniary jurisdiction of Banking Ombudsman or Rejection of Complaint

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SCHOOL OF MANAGEMENT STUDIES

UNIT – 4 – Banking and Insurance Management - SBAA7001

UNIT 4 – INSURANCE

Need for Insurance – Nature and Working of Insurance – Types of Insurance – Importance – Role of Insurance – Fundamental Principles of Insurance – Policy – Differentiation Insurance and Guarantee – Insurance and Wager – Disclosure – Moral Hazards.

HISTORY/ORIGIN OF INSURANCE

The idea of insurance took birth thousands of years ago. Yet, the business of insurance, as we know it today, goes back to just two or three centuries. Insurance has been known to exist in some form or other since 3000 BC. Various civilizations, over the years, have practiced the concept of pooling and dividing among themselves, all the losses suffered by some members of the community. Insurance through the ages - The Babylonian traders had agreements where they would pay additional sums to lenders, as a price for writing off the loans, in case a shipment was lost or stolen. These were called "bottomry loans". Similar practices were prevalent among the traders from Baruch and Surat sailing in Indian ships to Sri Lanka, Egypt and Greece. The Greeks had started benevolent societies in the late 7th century AD, to take care of the funeral – and families – of members who died. The Friendly societies of England were similarly constituted. • The inhabitants of Rhodes adopted a practice whereby, if some goods were lost due to jettisoning during distress, the owners of goods (even those who lost nothing) would bear the losses in proportion. Chinese traders in ancient days would keep their goods in different boats or ships sailing over the treacherous rivers. They assumed that if one of the boats suffered such a fate, the loss of goods would be only partial and not total. The loss could be distributed and thereby reduced. • "The Great Fire of London" in 1666, in which more than 13000 houses were lost, gave a boost to insurance and the first fire insurance company, called the Fire Office, was started in 1680. •

Lloyds: The origins of insurance business as practiced today, is traced to the Lloyd's Coffee House in London. Traders, who used to gather there, would agree to share the losses to their goods being carried by ships, due to perils of the sea. (maritime perils, such as pirates who robbed on the high seas or bad sea weather spoiling the goods or sinking of the ship due to perils of the sea.) In India, insurance has a deep-rooted history. It finds mention in the writings of Manu (Manusmrithi), Yagnavalkya (Dharmasastra) and Kautilya (Arthasastra). The writings talk in terms of pooling of resources that could be re-distributed in times of calamities such as fire, floods, epidemics and famine. This was probably a pre-cursor to modern day insurance. Ancient Indian history has preserved the earliest traces of insurance in the form of marine trade loans and carriers' contracts. Insurance in India has evolved over time heavily drawing from other countries, England in particular.

EVOLUTION OF INSURANCE IN MODERN INDIA

♣ 1818 saw the advent of life insurance business in India with the establishment of the Oriental Life Insurance Company in Calcutta. This Company however failed in 1834.

♣ In 1829, the Madras Equitable had begun transacting life insurance business in the Madras Presidency.

♣ 1870 saw the enactment of the British Insurance Act and in the last three decades of the nineteenth century, the Bombay Mutual (1871), Oriental (1874) and Empire of India (1897) were started in the Bombay Residency. This era, however, was dominated by foreign insurance offices which did good business in India, namely Albert Life Assurance, Royal Insurance, Liverpool and London Globe Insurance and the Indian offices were up for hard competition from the foreign companies.

♣ In 1914, the Government of India started publishing returns of Insurance Companies in India. The Indian Life Assurance Companies Act, 1912 was the first statutory measure to regulate life business.

♣ In 1928, the Indian Insurance Companies Act was enacted to enable the Government to collect statistical information about both life and non-life business transacted in India by Indian and foreign insurers including provident insurance societies.

♣ In 1938, with a view to protecting the interest of the Insurance public, the earlier legislation was consolidated and amended by the Insurance Act, 1938 with comprehensive provisions for effective control over the activities of insurers.

♣ The Insurance Amendment Act of 1950 abolished Principal Agencies. However, there were a large number of insurance companies and the level of competition was high. There were also allegations of unfair trade practices. The Government of India, therefore, decided to nationalize insurance business.

♣ An Ordinance was issued on 19th January, 1956 nationalizing the Life Insurance sector and Life Insurance Corporation came into existence in the same year. The LIC absorbed 154 Indian, 16 non-Indian insurers as also 75 provident societies—245 Indian and foreign insurers in all. The LIC had monopoly till the late 90s when the Insurance sector was reopened to the private sector.

♣ The history of general insurance dates back to the Industrial Revolution in the west and the consequent growth of sea-faring trade and commerce in the 17th century. It came to India as a legacy of British occupation. General Insurance in India has its roots in the establishment of Triton Insurance Company Ltd., in the year 1850 in Calcutta by the British. In 1907, the Indian Mercantile Insurance Ltd, was set up. This was the first company to transact all classes of general insurance business.

♣ 1957 saw the formation of the General Insurance Council, a wing of the Insurance Association of India. The General Insurance Council framed a code of conduct for ensuring fair conduct and sound business practices.

♣ In 1968, the Insurance Act was amended to regulate investments and set minimum solvency margins. The Tariff Advisory Committee was also set up then.

♣ In 1972 with the passing of the General Insurance Business (Nationalization) Act, general insurance business was nationalized with effect from 1 st January, 1973. 107 insurers were amalgamated and grouped into four companies, namely National Insurance Company Ltd., the New India Assurance Company Ltd., the Oriental Insurance Company Ltd and the United India Insurance Company Ltd. The General Insurance Corporation of India was incorporated as a company in 1971 and it commence business on January 1sst 1973.

♣ This millennium has seen insurance come a full circle in a journey extending to nearly 200 years. The process of re-opening of the sector had begun in the early 1990s and the last decade and more has seen it been opened up substantially. In 1993, the Government set up a committee under the chairmanship of RN Malhotra, former Governor of RBI, to propose recommendations for reforms in the insurance sector.

♣ The objective was to complement the reforms initiated in the financial sector. The committee submitted its report in 1994 wherein, among other things, it recommended that the private sector be permitted to enter the insurance industry. They stated that foreign companies be allowed to enter by floating Indian companies, preferably a joint venture with Indian partners.

♣ Following the recommendations of the Malhotra Committee report, in 1999, the Insurance Regulatory and Development Authority (IRDA) was constituted as an autonomous body to regulate and develop the insurance industry. The IRDA was incorporated as a statutory body in April, 2000. The key objectives of the IRDA include promotion of competition so as to enhance customer satisfaction through increased consumer choice and lower premiums, while ensuring the financial security of the insurance market.

♣ The IRDA opened up the market in August 2000 with the invitation for application for registrations. Foreign companies were allowed ownership of up to 26%. The Authority has the power to frame regulations under Section 114A of the Insurance Act, 1938 and has from 2000 onwards framed various regulations ranging from registration of companies for carrying on insurance business to protection of policyholders' interests.

♣ In December, 2000, the subsidiaries of the General Insurance Corporation of India were restructured as independent companies and at the same time GIC was converted into a national re-insurer. Parliament passed a bill de-linking the four subsidiaries from GIC in July, 2002.

♣ 2003: Introduction of Broker in Indian Insurance market.

♣ Then Insurance industry transformed into monopoly and Oligopolistic state or public sector insurance industry in India.

♣ Today there are 31 general insurance companies including the ECGC and Agriculture Insurance Corporation of India and 24 life insurance companies operating in the country.

♣ The insurance sector is a colossal one and is growing at a speedy rate of 15-20%. Together with banking services, insurance services add about 7% to the country's GDP. A well developed and evolved insurance sector is a boon for economic development as it provides long- term funds for infrastructure development at the same time strengthening the risk-taking ability of the country.

NATIONALIZATION OF INSURANCE SECTOR

By early 1970s, there were about 100 Indian insurers carrying on the general insurance business in India. Malpractices and mismanagement had crept into the management of these companies. Some insurance companies either liquidated or cheated the policy holders. There were complaints of falsification and denial of claims, interlocking of funds and other malpractices by many insurance companies. To protect public funds, the government started considering nationalization of the Insurance Industry. An Ordinance was issued on 19th January, 1956 nationalizing the Life Insurance sector and Life Insurance Corporation came into existence in the same year. The LIC absorbed 154 Indian, 16 non-Indian insurers as also 75 provident societies—245 Indian and foreign insurers in all. The LIC had monopoly till the late 90s when the Insurance sector was reopened to the private sector. In 1971, as a prelude to nationalization of the general insurance industry, the Govt. of India took over the management of all private general insurance companies. In the year 1972 General Insurance Business was nationalized. The main objective of this nationalization was to channelize the insurance funds for the benefit of the community at large. With the enactment of General Insurance Act 1972, General Insurance Corporation of India (GIC) was set up as a Holding Company. It had four subsidiaries: New India, Oriental, United India and National Insurance Companies. GIC was responsible for broad policy matters that could affect the general insurance industry in India. The company did not offer any direct insurance policies except the aviation insurance policies of Air India, Indian Airlines, Hindustan Aeronautics and Crop insurance. Thus General Insurance business was primarily conducted by the four subsidiaries of GIC. Apart from the four subsidiaries, GIC set up the GIC Asset Management Company to manage the GIC Mutual Fund, GIC Housing Finance, and Export Credit Guarantee Corporation.

LIBERALIZATION IN INSURANCE SECTOR

Although Indian Economy started opening up both to private sector and to foreign investment in the year 1991, Insurance sector still remained the domain of Govt. of India. However the Government realized that there was a need to bring reforms in the Insurance Sector in case this sector has to evolve. With a view to bring reforms in the Insurance Sector the Central Government formed Malhotra Committee headed by former Finance Secretary and RBI Governor R.N. Malhotra in the year 1993. Thus the Malhotra committee was set up with the objective of complementing the reforms initiated in the financial sector. The reforms were aimed at creating a more efficient and competitive financial system suitable for the requirements of the economy keeping in mind the structural changes currently underway and recognizing that insurance is an important part of the overall financial system where it was necessary to address the need for similar reforms. In 1994, the committee submitted the report and some of the key recommendations included:

A. Structure

a. Government stake in the insurance Companies to be brought down to 50%.

b. Government should take over the holdings of GIC and its subsidiaries so that these subsidiaries can act as independent corporations.

c. All the insurance companies should be given greater freedom to operate.

B. Competition

a. Private Companies with a minimum paid up capital of Rs.1bn should be allowed to enter the sector.

b. No Company should deal in both Life and General Insurance through a single entity.

c. Foreign companies may be allowed to enter the industry in collaboration with the domestic companies.

d. Postal Life Insurance should be allowed to operate in the rural market. e. Only one State Level Life Insurance Company should be allowed to operate in each state.

C. Regulatory Body

a. The Insurance Act should be changed.

b. An Insurance Regulatory body should be set up.

c. Controller of Insurance- a part of the Finance Ministry- should be made independent

D. Investments

a. Mandatory Investments of LIC Life Fund in government securities to be reduced from 75% to 50%.

b. GIC and its subsidiaries are not to hold more than 5% in any company (there current holdings to be brought down to this level over a period of time)

E. Customer Service

a. LIC should pay interest on delays in payments beyond 30 days.

b. Insurance companies must be encouraged to set up unit linked pension plans.

c. Computerization of operations and updating of technology to be carried out in the insurance industry. The committee emphasized that in order to improve the customer services and increase the coverage of insurance policies, industry should be opened up to competition. But at the same time, the committee felt the need to exercise caution as any failure on the part of new players could ruin the public confidence in the industry. Hence, it was decided to allow competition in a limited way by stipulating the minimum capital requirement of Rs.100 crores. The committee felt the need to provide greater autonomy to insurance companies in order to improve their performance and enable them to act as independent companies with economic motives. For this purpose, it had proposed setting up an independent regulatory body- The Insurance Regulatory and Development Authority.

IMPORTANT MILESTONES IN THE HISTORY OF INDIAN INSURANCE INDUSTRY

♣ 1993 Malhotra Committee established

♣ 1994 Recommendations of the Malhotra Committee published

♣ 1995 Mukherjee Committee established

♣ 1996 Setting up of (interim) Insurance Regulatory Authority (IRA)recommendations of the IRA

♣ 1997 Mukherjee Committee Report submitted but not made public

♣ 1997 The government gives greater autonomy to Life Insurance Corporation, General Insurance Corporation, and its subsidiaries with regard to the restructuring of boards and flexibility in investment norms aimed at channeling funds to the infrastructure sector

♣ 1998 The cabinet decides to allow 40 percent foreign equity in private insurance companies—26 percent to foreign companies and 14 percent to non-resident Indians and Foreign Institutional Investors

♣ 1999 The Standing Committee headed by MuraliDeora decides that foreign equity in private insurance should be limited to 26 percent. The IRA bill is renamed the Insurance Regulatory and Development Authority Bill

♣ 1999 Cabinet clears Insurance Regulatory and Development Authority Bill

♣ 2000 President gives assent to the Insurance Regulatory and Development Authority Bill

What is Insurance?

Insurance is a means of protection from financial loss. It is a form of Risk Management primarily used to Hedge against the risk of a Contingent, Uncertain loss. (or)An arrangement by which a company or the state undertakes to provide a guarantee of compensation for specified loss, damages, illness or death in return for payment of a specified premium.

Dictionary of business and Finance defines “Insurance as a form of contract agreement under which one party agrees in return for a consideration to pay an agreed amount of money to another party to make good a loss, damage or injury to something of value in which the insured has a interest as a result of some uncertain event.

Meaning of Insurance – Insurance means a promise of compensation for any potential future losses. It facilitates financial protection against by reimbursing losses during crisis. There are different insurance companies that offer wide range of insurance options and an insurance purchaser can select as per own convenience and preference. Several insurances provide comprehensive coverage with affordable premiums. Premiums are periodical payment and different insurers offer diverse premium options. The periodical insurance premiums are calculated according to the total insurance amount. In other words, a promise of compensation for specific potential future losses in exchange for a periodic payment. Insurance is designed to protect the financial well-being of an individual, company or other entity in the case of unexpected loss. Some forms of insurance are required by law, while others are optional. Agreeing to the terms of an insurance policy creates a contract between the insured and the insurer.

In exchange for payments from the insured (called premiums), the insurer agrees to pay the policy holder a sum of money upon the occurrence of a specific event. In most cases, the policy holder pays part of the loss (called the deductible), and the insurer pays the rest. Some important definitions of insurance are as follows: Insurance is cooperative form of distributing a certain risk over a group of persons who are exposed to it. Ghosh and Agarwal Insurance is an instrument of distributing the loss of few among many. Disnadle The collective bearing of risk is insurance. W. Beverideges

Main Branches of Insurance

- Accident Insurance

- Fire Insurance

- Holiday and Travel Insurance

- Household Insurance

- Liability Insurance

- Livestock and Bloodstock Insurance

- Marine Insurance

- Motor Insurance

- Pluvial Insurance

- Private Health Insurance

- Property Insurance

- Reinsurance

- Retrocession etc.

Basic Functions of Insurance

1.Primary Functions

2.Secondary Functions

3.Other Functions

1.Primary functions of insurance

(a) Providing protection — The elementary purpose of insurance is to allow security against future risk, accidents and uncertainty. Insurance cannot arrest the risk from taking place, but can for sure allow for the losses arising with the risk. Insurance is in reality a protective cover against economic loss, by apportioning the risk with others.

(b) Collective risk bearing — Insurance is an instrument to share the financial loss. It is a medium through which few losses are divided among larger number of people. All the insured add the premiums towards a fund and out of which the persons facing a specific risk is paid.

(c)Evaluating risk — Insurance fixes the likely volume of risk by assessing diverse factors that give rise to risk. Risk is the basis for ascertaining the premium rate as well. Provide Certainty — Insurance is a device, which assists in changing uncertainty to certainty.

2. Secondary functions of insurance

(a) Preventing losses — Insurance warns individuals and businessmen to embrace appropriate device to prevent unfortunate aftermaths of risk by observing safety instructions; installation of automatic sparkler or alarm systems, etc. '

(b) Covering larger risks with small capital — Insurance assuages the businessmen from security investments. This is done by paying small amount of premium against larger risks and dubiety. '

(c) Helps in the development of larger industries — Insurance provides an opportunity to develop to those larger industries which have more risks in their setting up.

3.Other functions of insurance

(a) Is a savings and investment tool — Insurance is the best savings and investment option, restricting unnecessary expenses by the insured. Also, to take the benefit of income tax exemptions, people take up insurance as a good investment option.

(b) Medium of earning foreign exchange — Being an international business, any country can earn foreign exchange by way of issue of marine insurance policies and a different other way.

(c) Risk Free trade — Insurance boosts exports insurance, making foreign trade risk free with the help of different types of policies under marine insurance cover. Insurance provides indemnity, or reimbursement, in the event of an unanticipated loss or disaster.

Importance of Insurance

I .Individual aspects:

(a) Security for health and property

(b) Encourage savings

(c)Encourage the habit of forced thrift

(d) Provide mental peace

(e) Increase efficiency

(f) Provision for the future

(g) Awareness for the future

(h) Credit Facility

(i) Tax exemption

(j) Contribution to the conservation of health

(k) Cover for legal liability

(l) Security to the mortgaged property

(m)Poster economic independence

II Economic aspects

1. Safety against risk

2. Protection to employees

3. Basis of Credit

4. Protection from the loss of key man

5. Encourage loss prevention methods

6. Reduction of cost

7. Promote foreign trade

8. Development of big industries

9. Increase in efficiency

III Social aspects

1. Stability in family life

2. Development of employment opportunity

3. Encourage alertness

4. Contributes to the development of basic facilities

IV National aspects

1. Increase the national savings

2. Helps in development opportunities

3. Develops the money market

4. Earns foreign exchange

5. Capitalizes the savings

Need for Insurance

1. Removal of uncertainties: Insurance company takes the risks of large but uncertain losses in exchange for small premium. So it gives a sense of security, which is real gift to the business man. If all uncertainty could be removed from business, income would be sure. Insurance removed many uncertainties and to that extent is profitable.

2. Stimulant of business enterprise: Insurance facilitates to maintain the large size commercial and industrial organizations. No large scale industrial undertaking could function in the modern world without the transfer of many of its risks to insurer. It safeguards capital and at the same time it avoids the necessity on the part of industrialists. They are therefore free to use their capital as may seem best.

3. Promotion of saving: Saving is a device of preparing for the bad consequences of the future. Insurance policy is often very suitable way of providing for the future. This type of policy is found particularly in life assurance. It promotes savings by making it compulsory which has a beneficial effect both for the individual and nation.

4. Correct distribution of cost: Insurance helps to maintain correct distribution of cost. Every business man tries to pass on to the consumer all types of costs including accidental and losses also. In the various fields of Insurance such losses are correctly estimated keeping in view a vast number of factors bearing on them. In the absence of insurance these losses and costs would be assessed and distributed only by guess work.

5. Source of credit: Modem business depends largely on credit; insurance has contributed ‘a lot in this regard. A life insurance policy increases the credit worthiness of the assured person because it can provide funds for repayment if he dies. Credit extension is also obtained by means of various kinds of property insurance. A businessman who stock of goods has been properly insured can get

credit easily. Similarly, marine insurance is an essential requirement for every transaction of import and export.

6. Reduction of the chances of loss: Insurance companies spend large sums of money with a view to finding out the reasons of fire accidents, theft and robbery and suggest some measures to prevent them. They also support several medical programs in order to make the public safety minded. Without such losses preventive activities of insurance companies, the chances of loss would have been greater than they are at present days.

7. Solution of social problems: Insurance serves as a useful device for solving complex social problems e.g. compensation is available to victims of Industrial injuries and road accident while the financial difficulties arising from old age, disability or death are minimized. It thus enables many families and business units to continue intact even after a loss.

8. Productive utilization of fund: Insurer accumulates large resources from the various insurance funds. Such resources are generally invested in the country, either in the public or private sector. This facilitates considerably in overall development of the economy.

9. Insurance as an investment: A life policy is a combination of protection and investment which serves a useful purpose. The premium that is paid by insured goes on accumulating in a fund every year. The sum so accumulated by the insurance company earns interest. Under life assurance a person may also invest his capital in an annuity which will pay him an income every year till death. Therefore, insurance may be regarded as an investment.

10. Promotion of international trade: The growth of the international trade of the country has been greatly helped by shifting of risk to insurance company. A ship sailing in the sea faces some misfortune. A fire breaks out and burns to ashes all the merchandise of a business man. But insurance is one of the devices by which these risks may be reduced or eliminated. So industrialists and exporter may devote their full attention toward the promotion of business which may increase the export activities.

11. Removing fear: Insurance helps to remove various types of fear from the mind of the people. The insured is secured in the knowledge that the protection of the insurance fund is behind him if

some sad event happens. It thus creates confidence and eliminates worries which are difficult to evaluate, but the benefit is very real.

12. Favourable allocation of factors of production: Insurance also helps in achieving favourable allocation of the factors of production. Capital is usually shy in the risky business. People hesitate to invest their capital where financial losses are great. If protection is provided against these risks by means of insurance, several investors will become ready to invest their funds in those fields.

13. Growth of Business competition: Insurance enables the small business units to compete upon more equal terms with the bigger organization. Without insurance it would have been impossible to undertake the risks themselves. On the other side bigger organization could absorb, their losses due to great financial strength. Moreover insurance removes uncertainty of financial losses arising out of the certain causes. It thus increases knowledge which is one of the most important preconditions of perfect competition.

14. Employment opportunity: Insurance provides employment opportunity to jobless persons which is helpful for the improvement and progress of social condition

15. Miscellaneous benefits: Following are some other miscellaneous benefits offered by insurance:
(a) It establishes the relation between the employed and employer by providing various facilities i.e. group life insurance, social security scheme, retirement income plan, and workman's compensation insurance.

(b) Insurance creates the confidence and sense of security among the policy holder.

(c) Insurance company provides valuable services of skilled and expert persons to industries and business in order to eliminate various risks.

(d) It promotes economic growth and development. This would be impossible in the Notes absence of insurance.

(e) It contributes to the efficiency of business and also industrial and commercial executives.

(f) Security of dependents is made possible through life assurance. It gives relief to helpless families after the death of the earning member of the family.

Importance of Insurance in Business

1. Theft: A new business is a big target for thieves. New computers, furniture and other office equipment are worth more at a pawn or chop shop than older equipment. Even older businesses that have just undergone renovations and upgrades are a target. Replacement insurance protects a business in the event of stolen equipment, replacing the missing items and paying for repairs from damage caused by the invasion.

2. Liability: If a customer slips and falls while on your business premises or your product has a defect that injures a customer and you do not have insurance, this could spell the end of your business. If a company car is involved in an accident and someone is injured, that could be disastrous as well. Business liability insurance covers accidents that occur on the business premises, product defects and mishaps that occur during normal business operations on and off premises.

3. Level of Coverage: How much insurance to carry will depend on your industry, the business structure and the amount of assets your business has. Example: A law firm partnership that owns the building in which it is housed might need more insurance than a jewellery designer operating out of her home.

4. Litigation: We live in a litigious society. Even with the Texas tort reform legislation passed in 2003, which capped judgments and sought to eliminate frivolous lawsuits, businesses are sued by individuals and other businesses for a variety of reasons, legitimate and otherwise. Even the most frivolous lawsuit can be costly to defend; and in the event business ends up on the losing end of a lawsuit, the awarded damages could exceed the business's capabilities to pay. Depending on the business entity structure, not only the business assets, but also the owner's personal assets could be at risk. Business liability insurance, malpractice insurance or professional liability insurance will cover at least part, if not all, of any damages.

5. Catastrophic Loss: Business insurance protects a business from closing due to a catastrophic loss. Fires, floods, hurricanes and tornadoes have been the end of many businesses in Texas, as elsewhere. When a company carries insurance against these types of losses, closure and loss are only temporary instead of permanent. Companies should always consider business interruption

insurance, a rider on their business insurance policy, to ensure continued cash flow for the duration of a closure due to a natural disaster.

6. Personal Injury or Illness: Business owners should have personal insurance as well. Medical insurance will ensure medical bills incurred due to an illness or injury will not wipe out a business's assets.

Nature of Insurance

1. Risk Sharing and Risk Transfer: Insurance is a device to share the financial losses, which might occur to an individual or his family on the happening of a specified event. The event may be death of the earning member of the family in the case of life insurance, marine perils in marine insurance, fire in fire insurance and other certain events in miscellaneous insurance, e.g., theft in burglary insurance, accidents in motor insurance, etc. The loss arising from these events if insured are shared by all the insured in the form of premium which they have already paid in advance. Hence, the risk is transferred from one individual to a group.

2. Co-operative Device: A group of persons who agree to share the financial loss may be brought together voluntarily or through publicity or through solicitations of the agents. An insurer, by insuring a large number of persons, is able to pay the amount of loss. Like all co-operative devices, there is no compulsion here on anybody to purchase the insurance policy (third party liability insurance in case of a vehicle owner is an exception).

3. Calculates Risk in Advance: The risk is evaluated on the basis of probability theory before insuring since the premium payable on a policy is to be determined. Probability theory is that body of knowledge, which is concerned with measuring the likelihood that something will happen and making estimates on the basis of this likelihood.

4.Payment of Claim at the Occurrence of Contingency: The payment is made on happening of a certain insured contingency. It is true for all non-life insurances that payment will be made on the happening of the specified contingency only. The life insurance claim is a certainty, because the contingency of death or the expiry of term will certainly occur and the payment is certain. Similarly, in certain types of life policies, payment is not certain due to uncertainty of a particular contingency within a particular period. Example: In term-insurance the payment is made only when death of the assured occurs within the specified term, may be one or two years. Similarly, in pure endowment, payment is made only at the survival of the insured at the Notes expiry of the period.

5. Amount of Payment: The amount of payment depends upon the value of loss suffered due to the happening of that particular insured risk, provided insurance is there up to that amount. In life insurance, the purpose is not to make good the financial loss suffered. Moreover, one cannot estimate the value of a human being. A person is no doubt precious to his/her family. The insurer promises to pay a fixed sum on the happening of an event i.e. death or permanent disability. The amount of loss at the time of contingency is immaterial in life insurance. But in the property and general insurances, the amount of loss, as well as the happening of loss, is required to be proved.

6. Larger Number of Insured Persons: The price of insurance is basically linked to the cost of claims, which is only known subsequently. In the beginning, it is an unknown factor and an estimate is made on the basis of past claims experience or empirical data about the longevity of human beings, accidents and their financial consequences. Generally, the past claims experience is repeated with minor variations if a large number of risks are collected. This once again operates by the law of large numbers and is one reason why insurance companies want to do as much business as possible.

7.Insurance must not be confused with Charity or Gambling: The uncertainty is changed into certainty by insuring property and life because the insurer promises to pay a definite sum at damage or death. In the absence of insurance, the property owner could at the best, practice only some form of self-insurance, which may not give him absolute certainty. A family is protected against losses on death and damage with the help of insurance. From the point of view of an insurance company, the insurance contract is essentially non speculative. In fact, no other business operates with greater certainties. From the insured’s point of view, too, insurance is also not gambling. Failure of taking insurance, however, amounts to gambling because the uncertainty of loss is always looming on the head. One could also say that the insurance is just the opposite of gambling. In gambling, by bidding, the person exposes himself to risk of losing, but the insured safeguards himself through insurance, and may suffer loss only if he is not insured.

Types of Insurance

The following are the various types of insurance businesses recognised under the Insurance Act, 1938:

(a) Life insurance business

(b) General insurance business (also called "Non-Life" business).This is sub divided into the following 3 sub-categories:

1. Fire insurance business

2. Marine insurance business

3. Miscellaneous insurance business

(I) Life Insurance Policies - Life Insurance refers to a policy or cover whereby the policyholder can ensure financial freedom for his/her family members after death. Suppose you are the sole earning member in your family, supporting your spouse and children.

In such an event, your death would financially devastate the whole family. Life insurance policies ensure that such a thing does not happen by providing financial assistance to your family in the event of your passing.

Types of Life Insurance Policies

A. Term Insurance Term Insurance is the simplest form of life insurance. It pays only if death occurs during the term of the policy, which is usually from one to 30 years. Most term policies have no other benefit provisions. Thus, the features of Term Insurance Plan are as follows: ¾ It is a pure life cover i.e. in the event of death of the insured the sum assured is paid to the family (beneficiaries). ¾ in case the insured survives the policy term, there is no return of premium. ¾ There is no investment component in a term plan Example Mr. X took a term insurance plan from ABC Life Insurance Co. Ltd. for a period of 20 years and sum assured of Rs.10lacs. In the event of his death, Rs.10lacs would be paid to Mrs. X. If Mr. X survives the term, there will be no return of premium.

B. Whole Life Insurance Under this policy premiums are paid throughout life and the sum insured becomes payable only at the death of the insured. The policy remains in force throughout the life of the assured and he continues to pay the premium till his death. This is the cheapest policy as the premium is to be paid till the death of the Insured. This is the cheapest policy as the premium charged is the lowest under this policy. This is also known as ‘ordinary life policy’. This policy is suitable to persons who want to make bequeathments for charitable purposes and to provide for their families after their death.

C. Endowment Plans An endowment policy is a saving linked Insurance policy with a specific maturity date. Under this policy the sum assured becomes payable if the assured reaches a particular age or after the expiry of a fixed period called the endowment period or at the death of the assured whichever is earlier. The premium under this policy is to be paid up to the maturity of the policy i.e. the time when the policy becomes payable. Premium would be little higher in case of this policy than the whole life policy. This is a very popular policy these days as it serves the dual purpose securing the family and /or saving for the retirement.

D. Children Policies: These types of policies are taken on the life of the parent/children for the benefit of the child. By such policy the parent can plan to get funds when the child attains various stages in life. Some Insurers offer waiver of premium in case of unfortunate death of the parent/proposer during the term of the policy.

E. Annuity/ Pension Plans: When an employee retires, he no longer gets his salary while his need for a regular income continues. Retirement benefits like Provident Fund and gratuity are paid in lump sum which are often spent too quickly or not invested prudently with the result that the employee finds himself without regular income in his post - retirement days. Pension is therefore an ideal method of retirement provision because the benefit is in the form of regular income. It is wise to provide for old age, when we have regular income during our earning period to take care of rainy days. Financial independence during old age is a must for everybody. This issue of having regular income during old age is taken care off by Annuity Policies. It is a policy under which the insured amount is payable to the assured by monthly or annual instalments after he attains a certain age. The assured may pay the premium regularly over a certain period or he may pay the premium regularly over a certain period or he may a lump sum of money at the outset. These policies are useful to persons who wish to provide a regular income for themselves and their dependents.

F. Money Back Policies Money Back Plan is a special type of Life Insurance Policy. Under this policy the money comes back to the Life Insured after specified intervals of time as Survival Benefits. However, if the Life insured dies during the term of the policy then the death benefit will be paid to the nominee and the policy would be terminated and no further money would be paid to him at regular intervals. Thus a money back policy is an endowment policy with liquidity benefit. The maturity benefit comes in instalments instead of Lump Sum at the end of the term of the policy. These benefits received at regular intervals are called Survival Benefits. Each installment is a percentage of sum assured. The remaining bit comes from maturity benefit at the end of the term of the policy. Illustration Bhakt Sethi has opted for a Money Back Life Insurance Policy. His plan has a Sum Assured of 5 lakhs for a policy term of 25 years. He would need to paypremiums for 25 years. And he would get back a part of the Sum Assured at regular intervals. For example, for a policy of 25 years, he would get 15% of Sum Assured after the 5th, 10th, 15th and 20th year of the policy i.e. he gets 15 X 4 = 60% of the Sum Assured as Survival Benefit. On Maturity of the policy he would get the remaining 40% of the Sum assured.

G. Group Insurance- Group insurance refers to the life insurance protection to group of persons. Opting for group insurance provides the advantage of a standardized cover to the group at competitive rates. They are suitable for large part of population who cannot afford individual life cover. Further members of an eligible group who otherwise cannot be insured can benefit through group insurance. Once the conditions of group insurance are satisfied, members can get life insurance at significantly lower rates compared to individual policies. The group may consist of employees, doctors, lawyers, credit societies etc. A group insurance scheme can be either

a. Contributory scheme – In this case the premium on the group life insurance policy is paid by both the employer and the employee.

b. Non-Contributory scheme – In this case premium is paid by the employer or the main agency fully.

H. Unit Linked Insurance Plan Unit linked insurance plans (ULIPs) aim to serve both the protection and investment objectives of investing. ULIP's are subject to capital market risks.

Objectives of Life Insurance

Life Insurance is a financial cover for a contingency or risk linked with human life such as loss of life by death, disability, accident, retirement etc. Thus the risk to human life is due to natural factors or causes related to various types of accidents. When human life is lost or a person is disabled permanently or temporarily there is a loss of income to the entire household. It is not possible to value human life rather it would be more appropriate to say that it is beyond any value. However, a method to determine loss would be to assess the same on the basis of loss of income in the future years, also known as Human Life Value.

Thus Life Insurance policies provide for a definite amount of money to be paid by the Insurer in the event the Insured dies during the term of the policy. Thus the essential features of life insurance can be summed up as under:

- It is a contract relating to human life.
- There need not be an express provision that payment is due on the death of a person.
- A definite agreed money known as premium needs to be paid for starting a Life Insurance Contract/Policy.
- The contract provides for payment of lump sum money
- The amount is paid at the expiration of a certain period or on the death of a person.

Advantages of Life Insurance

Life Insurance provides dual benefits to the persons taking such insurance. These dual benefits are savings and security. The following factors explain as to why this investment tool should be a part of one's financial plans.

A. Risk Cover Life is today full of uncertainties. In this scenario Life Insurance ensures that the loved ones of the Insured continue to enjoy good quality of life against any unforeseen circumstances

B. Planning Life Stage Needs Life Insurance not only provides for financial support in the event of untimely death but also acts as a long-term investment. One can meet one's goals, be it children's education, their marriage, building one's dream home or planning a relaxed retired life.

C. Habit of Saving Life Insurance is a long-term contract whereas policy holder one has to pay a fixed amount at specified periods. This builds the habit of Long term savings. Regular Savings over a long period ensures that a decent corpus is built to meet various needs at different stages of life.

D. Safety of Investment The investment made in Life Insurance is quite safe as Life Insurance is a highly regulated sector. The body that regulates Insurance Sector in India is called IRDA (Insurance Regulatory and Development Authority)

E. Liquidity Life Insurance provides good liquidity to the Policy Holder as they have the option of taking loan against their policy. Thus when there is an urgent need of funds, the insured can avail the facility of loan against his policy which will, however, depend upon the surrender value of the Policy.

F. Tax Benefits The premiums paid for life insurance policies and the amounts received in the event of death or on maturity of the said policy attract tax benefits.

II.GENERAL INSURANCE POLICY

- A policy or agreement between the policyholder and the insurer which is considered only after realization of the premium.
- The premium is paid by the insurer who has a financial interest in the asset covered.
- The insurer will protect the insured from the financial liability in case of loss.

How does the concept of General Insurance work?

Insurance is a concept that applies to a large group of people which may suffer the same risk in the same conditions or region. The money collected as the premium can be called as a pool and when anyone faces a loss, the person is paid from that pool.

Still perplexed at how does a general insurance policy come into play? Consider that your mother suffered a heart attack suddenly and she needs a transplant. At the same time, your daughter's college fee was due. It definitely is a huge expense to be made at the same time and none can be preferred over the other. In this time of stress, the family's health insurance policy can save your burden and the fees can be paid from the savings. A General Insurance Policy here works to save your burden for money.

Why do we need General Insurance?

Imagine you're driving back home in your car and suddenly, a taxi hits you from behind. Your car has a dent and its bumper has come off too. Now you need about Rs. 2000/- for the dent and Rs.7500/- for the bumper to be able to fix it all.

A car insurance policy, in this case, will play well. You can get the amount reimbursed under the insurance policy. Your car is the asset here in which you have a financial interest. But remember, an insurance policy will pay only as per its predefined conditions.

(a) Fire Insurance

Fire insurance pays or compensates for the damages caused to your property or goods due to fire. It covers the replacement, reconstruction or repair expenses of the insured property as well as the surrounding structures. It also covers the damages caused to a third-party property due to fire. In addition to these, it takes care of the expenses of those whose livelihood has been affected due to fire.

Types of fire insurance

Some of the common types are:

Valued policy	The insurer firsts value the property and then undertakes to pay compensation up to that value in the case of loss or damage.
Floating policy	It covers the damages to properties lying at different places.
Comprehensive policy	This is known as an all-in-one policy. It has a wide coverage and includes damages due to fire, theft, burglary, etc.
Specific policy	This covers you for a specific amount which is less than the real value of the property.

(b) Motor Insurance

Motor Insurance refers to policies that offer financial assistance in the event of accidents involving your car or bike. Motor insurance can be availed for three categories of motorised vehicles, including:

- Car Insurance - Personally owned four-wheeler vehicles are covered under such a policy.

- Two-wheeler Insurance - Personally owned two-wheeler vehicles, including bikes and scooters, are covered under these plans.
- Commercial Vehicle Insurance - If you own a vehicle that is used commercially, you need to avail insurance for the same. These policies ensure that your business automobiles stay in the best of shapes, reducing losses significantly.

Types of Motor Insurance Policies

Based on the extent of cover or protection offered, motor insurance policies are of three types, namely:

- **Third-Party Liability** - This is the most basic type of motor insurance cover in India. It is the minimum mandatory requirement for all motorised vehicle owners, as per the Motor Vehicles Act of 1988. Due to the limited financial assistance, premiums for such policies also tend to be low. These insurance plans only pay the financial liability to the third-party affected in the said mishap, ensuring that you do not face legal hassle due to the accident. They, however, do not offer any financial assistance to repair the policyholder's vehicle after accidents.
- **Comprehensive Cover** - Compared to the third-party liability option, comprehensive insurance plans offer better protection and security. Apart from covering third party liabilities, these plans also cover the expenses incurred for repairing the damages to the policyholder's own vehicle due to an accident. Additionally, comprehensive plans also offer a payout in case your vehicle sustains damage due to fire, man-made and natural calamities, riots and others such instances. Lastly, you can recover your bike's cost if it gets stolen, when you have a comprehensive cover in place. One can also opt for several add-ons with their comprehensive motor insurance policy that can make it better-rounded. Some of these add-ons include zero depreciation cover, engine and gear-box protection cover, consumable cover, breakdown assistance, etc.
- **Own Damage Cover** - This is a specialized form of motor insurance, which insurance companies offer to consumers. Further, you are eligible to avail such a plan only if you purchased the two-wheeler or car after September 2018. The vehicle must be brand new and not a second-hand one. You should also remember that you can avail this standalone own damage cover only if you already have a third party liability motor insurance policy in place. With own damage cover, you basically receive the

same benefits as a comprehensive policy without the third-party liability portion of the policy.

Benefits of Motor Insurance Policies

Cars and bikes are increasingly more expensive with each passing day. At such a time, staying without proper insurance can lead to severe monetary losses for the owner. Listed below are some advantages of purchasing such a plan.

- **Prevents Legal Hassle** - Helps you avoid any traffic fines and other legalities that you would otherwise need to bear.
- **Meets All Third-Party Liability** - If you injure a person or damage someone's property during a vehicular accident, the insurance policy helps you meet the monetary losses, effectively.
- **Financial Assistance to Repair Your own Vehicle** - After accidents, you need to spend considerable sums on repairing your own vehicle. Insurance plans limit such out of pocket expenses, allowing you to undertake repairs immediately.
- **Theft/loss cover** - If your vehicle is stolen, your insurance policy will help you reclaim a portion of the car/bike's on-road price. You can expect similar assistance if your vehicle is damaged beyond repair due to accidents.

Additionally, individuals who own a commercial car/two-wheeler can also avail tax benefits if they pay premiums for that vehicle.

(c) Health Insurance

Health insurance refers to a type of general insurance, which provides financial assistance to policyholders when they are admitted to hospitals for treatment. Additionally, some plans also cover the cost of treatment undertaken at home, prior to a hospitalization or after discharge from the same.

With the rising medical inflation in India, buying health insurance has become a necessity. However, before proceeding with your purchase, consider the various types of health insurance plans available in India.

Types of Health Insurance policies

There are eight main types of health insurance policies available in India. They are:

- **Individual Health Insurance** - These are healthcare plans that offer medical cover to just one policyholder.
- **Family Floater Insurance** - These policies allow you to avail health insurance for your entire family without needing to buy separate plans for each member. Generally, husband, wife and two of their children are allowed health cover under one such family floater policy.
- **Critical Illness Cover** - These are specialized health plans that provide extensive financial assistance when the policyholder is diagnosed with specific, chronic illnesses. These plans provide a lump-sum payout after such a diagnosis, unlike typical health insurance policies.
- **Senior Citizen Health Insurance** - As the name suggests, these policies specifically cater to individuals aged 60 years and beyond.
- **Group Health Insurance** - Such policies are generally offered to employees of an organization or company. They are designed in such a way that older beneficiaries can be removed, and fresh beneficiaries can be added, as per the company's employee retention capability.
- **Maternity Health Insurance** - These policies cover medical expenses during pre-natal, post-natal and delivery stages. It covers both the mother as well as her newborn.
- **Personal Accident Insurance** - These medical insurance policies only cover financial liability from injuries, disability or death arising due to accidents.
- **Preventive Healthcare Plan** - Such policies cover the cost of treatment concerned with preventing a severe disease or condition.

Benefits of Health Insurance

After assessing the various kinds of health insurance available, you must be wondering why availing such a plan is essential for you and your loved ones. Look at the reasons listed below to understand why.

- **Medical Cover** - The primary benefit of such insurance is that it offers financial coverage against medical expenditure.
- **Cashless Claim** - If you seek treatment at one of the hospitals that have tie-ups with your insurance provider, you can avail cashless claim benefit. This feature ensures that all medical bills are directly settled between your insurer and hospital.

- **Tax Benefits** - Those who pay health insurance premiums can enjoy income tax benefits. Under Section 80D of the Income Tax Act one can avail a tax benefit of up to Rs.1 Lakh on the premium payment of their health insurance policies.

(d) Travel Insurance

When talking about the different types of insurance policies, one must not forget to learn more about travel insurance plans. Such policies ensure the financial safety of a traveller during a trip. Therefore, when compared to other insurance policies, travel insurance is a short-term cover.

Depending on the provider you choose, travel insurance may offer financial aid at various times, such as during loss of baggage, trip cancellation and much more. Here is a look at some of the different types of travel insurance plans available in the country:

- **Domestic Travel Insurance** - This is the kind of travel insurance policy that safeguards your finances during travels within India. However, if you plan to step outside the country for a vacation, such a policy would not offer any aid.
- **International Travel Insurance** - If you are stepping out of the country, ensure you pick an international travel insurance plan. It allows you to cover the unforeseen expenses that can arise during your trip like medical emergencies, baggage loss, loss of passport, etc.
- **Home Holiday Insurance** - When you are travelling with family, your home remains unguarded and unprotected. Chances of burglary are always significant, which may lead to significant losses. Thankfully, with home holiday insurance plans, which are often included within travel policies, you are financially protected from such events as well.

Benefits of Travel Insurance

The following aspects are covered under travel insurance plans:

- **Cover Flight Delay** - Flight delays or cancellations can lead to significant losses for the passenger. If you buy travel insurance, you can claim such financial losses from the insurer.
- **Baggage Loss/Delay** - Travel insurance lets you claim monetary assistance if there is a delay or you happen to lose your luggage during the trip. With this amount, you can purchase some of the necessary items.

- **Reclaim Lost Travel Documents** - Visa and passport are essential documents during an international trip. Opting for international travel insurance ensures that you have the necessary financial backing to reapply for interim or replacement documents as and when necessary.
- **Trip Cancellation Cover** - A sudden death in the family or a medical emergency may play spoilsport with your travel arrangements. Thankfully, international travel insurance plans support trip cancellations in such events. You can claim financial assistance to pay penalties and cancellation charges for flights, hotels, etc.

(e) **Property Insurance** - Any building or immovable structure can be insured through property insurance plans. This can be either your residence or commercial space. If any damage befalls such a property, you can claim financial assistance from the insurance provider. Keep in mind that such a plan also financially safeguards the content inside the property.

Types of Property Insurance in India

Here are some types of property insurance policies available in India:

- **Home Insurance** - With such a policy, you remain free from all financial liabilities that may arise from damage to your home or contents inside due to fires, burglaries, storms, earthquakes, explosions and other events.
- **Shop Insurance** - If you own a shop, which acts as a source of income for you, it is integral to protect yourself from financial liability arising from the same. Whether the liability occurs due to natural calamities or due to accidents, with these plans, you can immediately undertake repairs to the shop.
- **Office Insurance** - Another type of property insurance policy, office insurance ensures that the office building and all the equipment inside are significantly protected in the event of unforeseen events. Generally, office spaces include expensive equipment, such as computers, servers and much more. Thus, availing these plans is essential.
- **Building Insurance** - If you own a complete building, opting for home insurance may not be sufficient. Instead, you can purchase building insurance to cover the entire premises.

Benefits of Property Insurance

- **Protection against Fires -** While the insurance policy cannot prevent fires, it can prevent financial liabilities from such an event.
- **Burglaries -** If your property exists in an area prone to theft and burglaries, such a policy is vital to ensure financial security.
- **Floods -** In certain parts of India, floods are common. These floods can ravage your property leading to substantial losses. Property insurance also protects against such events.
- **Natural Calamities -** The plan also offers financial aid against damage arising from earthquakes, storms and more.

Rebuilding or renovation of a property is immensely expensive. Thus, property insurance policies are the best option to ensure long-term financial health.

(f) Mobile Insurance

Owing to the rising price of mobile phones and their several applications today, it has become imperative to insure the device. Mobile insurance allows you to reclaim money that you spend on repairing your phone in the event of accidental damage.

Further, you can also claim the same in case of phone theft, making it easier to replace the handset with a new phone.

Benefits of Mobile Insurance

Mobile insurance policies are extremely beneficial, especially for those who own a premium smartphone.

- **Comprehensive protection for new devices -** The value of phones tends to decline with time. Thus, when the handset is new, phone insurance can help safeguard its significant value.
- **Coverage against Damage to Screen -** If you accidentally damage the smartphone screen, which is one of the most important parts of such devices, your insurance plan will pay for the repair expenses.
- **Theft or Robbery of Smartphone -** Nothing is worse than buying your dream smartphone and losing it due to theft or burglary. Well, phone insurance will help you afford a replacement handset if such an unfortunate thing happens.

Some insurers may not allow you to buy insurance for the smartphone after a month or two passes from the purchase of the handset.

(g) Cycle Insurance

Bicycles are valuable properties in India as some people rely on these vehicles for their daily commute. A cycle insurance policy ensures that you have access to necessary funds should your bicycle undergo accidental damage or theft. It saves your out of pocket expenses, while also ensuring immediate repairs to the vehicle.

Benefits of Cycle Insurance

The advantages of availing such an insurance policy are:

- **Worldwide Coverage -** Depending on the insurance provider, cycle insurance policies provide financial assistance regardless of where your bicycle undergoes damage. Even if you meet with a cycling accident in a different country, such a plan will offer aid.
- **Protection against Fires and Riots -** If your bicycle sustains damage due to accidental fires and/or rioting, insurance policies will provide the necessary financial assistance to repair or undo the damage.
- **Accidental Death Benefit -** If you pass away due to bicycle accidents, the insurance policy for the cycle would offer a lump-sum payout to your surviving family members.

Regardless of your cycle's price, opting for insurance can reduce your financial liabilities significantly.

(h) Bite-Size Insurance

Bite-sized insurance policies refer to sachet insurance plans that minimize your financial liability for a very limited tenure, generally up to a year.

These insurance plans allow you to protect your finances against specific damage or threats.

For instance, particular bite-sized insurance may offer accidental cover of Rs. 1 Lakh for a year. You can choose this policy when you think you might be particularly susceptible to accidental injuries.

Another example is insurance cover for specific diseases. For instance, if your area is prone to water-borne diseases, such as cholera, you can pick a policy that covers cholera treatment and all associated costs for a 1-year period.

Benefits of Bite-sized Insurance

The primary benefit of bite-size insurance policies is that it allows you to avail financial protection at very limited prices.

The premiums are so low that it hardly makes any impact on your overall monthly expenditures. In comparison, the sum insured is significant.

Principles of Insurance

The business of insurance aims to protect the economic value of assets or life of a person. Through a contract of insurance, the insurer agrees to make good any loss on the insured property or loss of life (as the case may be) that may occur in course of time in consideration for a small premium to be paid by the insured. Apart from the above essentials of a valid contract, insurance contracts are subject to additional principles.

These are:

1. Principle of Utmost good faith

2. Principle of Insurable interest

3. Principle of Indemnity

4. Principle of Subrogation

5. Principle of Contribution

6. Principle of Proximate cause

7. Principle of Loss of Minimization

These distinctive features are based on the basic principles of law and are applicable to all types of insurance contracts. These principles provide guidelines based upon which insurance agreements are undertaken. A proper understanding of these principles is therefore necessary for a clear interpretation of insurance contracts and helps in proper termination of contracts, settlement of claims, enforcement of rules and smooth award of verdicts in case of disputes.

1. **Principle of Uberrimae Fidei** (Utmost Good Faith)

• Both the parties i.e. the insured and the insurer should have a good faith towards each other.

• The insurer must provide the insured complete, correct and clear information of subject matter.
• The insurer must provide the insured complete, correct and clear information regarding terms and conditions of the contract.

• This principle is applicable to all contracts of insurance i.e. life, fire and marine insurance. Principle of Uberrimae fidei (a Latin phrase), or in simple English words, the Principle of Utmost Good Faith, is a very basic and first primary principle of insurance.

According to this principle, the insurance contract must be signed by both parties (i.e. insurer and insured) in an absolute good faith or belief or trust. The person getting insured must willingly disclose and surrender to the insurer his complete true information regarding the subject matter of insurance. The insurer's liability gets void (i.e legally revoked or cancelled) if any facts, about the subject matter of insurance are either omitted, hidden, falsified or presented in a wrong manner by the insured.

The principle of Uberrimae fidei applies to all types of insurance contracts.

For example, if any person has taken a life insurance policy by hiding the fact that he is a cancer patient and later on if he dies because of cancer then insurance company can refuse to pay the compensation as the fact was hidden by the insured.

2. Principle of Insurable Interest

• The insured must have insurable interest in the subject matter of insurance.

• In life insurance it refers to the life insured.

• In marine insurance it is enough if the insurable interest exists only at the time of occurrence of the loss.

• In fire and general insurance, it must be present at the time of taking policy and also at the time of the occurrence of loss.

• The owner of the party is said to have insurable interest as long as he is the owner of it.

• It is applicable to all contracts of insurance. The principle of insurable interest states that the person getting insured must have insurable interest in the object of insurance. A person has an insurable interest when the physical existence of the insured object gives him some gain but its non-existence will give him a loss. In simple words, the insured person must suffer some financial loss by the damage of the insured object.

For example: - The owner of a taxicab has insurable interest in the taxicab because he is getting income from it. But, if he sells it, he will not have an insurable interest left in that taxicab. From above example, we can conclude that, ownership plays a very crucial role in evaluating insurable interest. Every person has an insurable interest in his own life. A merchant has insurable interest in his business of trading. Similarly, a creditor has insurable interest in his debtor.

For example, if a person has taken the loan against the security of a factory premises then the lender can take fire insurance policy of that factory without being the owner of the factory because he has financial interest in the factory premises.

3. Principle of Indemnity

• Indemnity means guarantee or assurance to put the insured in the same position in which he was immediately prior to the happening of the uncertain event. The insurer undertakes to make good the loss.

• It is applicable to fire, marine and other general insurance.

• Under this the insurer agreed to compensate the insured for the actual loss suffered. Indemnity means security, protection and compensation given against damage, loss or injury.

According to the principle of indemnity, an insurance contract is signed only for getting protection against unpredicted financial losses arising due to future uncertainties. Insurance contract is not made for making profit else its sole purpose is to give compensation in case of any damage or loss. In an insurance contract, the amount of compensations paid is in proportion to the incurred losses.

The amount of compensations is limited to the amount assured or the actual losses, whichever is less. The compensation must not be less or more than the actual damage. Compensation is not paid if the specified loss does not happen due to a particular reason during a specific time period. Thus, insurance is only for giving protection against losses and not for making profit.

However, in case of life insurance, the principle of indemnity does not apply because the value of human life cannot be measured in terms of money.

For example, a person insured a car for 2.5 lakh against damage on an accident case. Due to accident he suffered a loss of 1.5 lakh, then the insurance company will compensate him 1.5 lakh only not the policy amount i.e., 2.5 lakh as the purpose behind it is to compensate not to make profit.

4. Principle of Subrogation

• As per this principle after the insured is compensated for the loss due to damage to property insured, then the right of ownership of such property passes to the insurer.

• This principle is corollary of the principle of indemnity and is applicable to all contracts of indemnity. Subrogation means substituting one creditor for another. Principle of Subrogation is an extension and another corollary of the principle of indemnity. It also applies to all contracts of indemnity. According to the principle of subrogation, when the insured is compensated for the losses due to damage to his insured property, then the ownership right of such property shifts to the insurer. This principle is applicable only when the damaged property has any value after the event causing the damage. The insurer can benefit out of subrogation rights only to the extent of the amount he has paid to the insured as compensation.

For example:- Mr. Arvind insures his house for Rs. 1 million. The house is totally destroyed by the negligence of his neighbor Mr. Mohan. The insurance company shall settle the claim of Mr. Arvind for Rs. 1 million. At the same time, it can file a law suit against Mr. Mohan for Rs. 1.2 million, the market value of the house. If insurance company wins the case and collects Rs. 1.2 million from Mr. Mohan, then the insurance company will retain Rs. 1 million (which it has already paid to Mr. Arvind) plus other expenses such as court fees. The balance amount, if any will be given to Mr. Arvind, the insured.

5. **Principle of contribution** • The principle is corollary of the principle of indemnity. • It is applicable to all contracts of indemnity. • Under this principle the insured can claim the compensation only to the extent of actual loss either from any one insurer or all the insurers. Principle of Contribution is a corollary of the principle of indemnity. It applies to all contracts of indemnity, if the insured has taken out more than one policy on the same subject matter. According to this principle, the insured can claim the compensation only to the extent of actual loss either from all insurers or from any one insurer. If one insurer pays full compensation then that insurer can claim proportionate claim from the other insurers.

For example :- Mr. Arvind insures his property worth Rs. 100,000 with two insurers "AIG Ltd." for `90,000 and "MetLife Ltd." For `60,000. Arvind's actual property destroyed is worth Rs. 60,000, then Mr. Arvind can claim the full loss of `60,000 either from AIG Ltd. or MetLife Ltd., or he can claim `36,000 from AIG Ltd. and `24,000 from Metlife Ltd. So, if the insured claims full amount of compensation from one insurer then he cannot claim the same compensation from other insurer and make a profit. Secondly, if one insurance company pays the full compensation then it can recover the proportionate contribution from the other insurance company.

6. **Principle of Causa Proxima** (NEAREST CAUSE)

• The loss of insured property can be caused by more than one cause in succession to another.

• The property may be insured against some causes and not against all causes.

• In such an instance, the proximate cause or nearest cause of loss is to be found out.

• If the proximate cause is the one which is insured against, the insurance company is bound to pay the compensation and vice versa. Principle of Causa Proxima (a Latin phrase), or in simple english words, the Principle of Proximate (i.e Nearest) Cause, means when a loss is caused by more than one causes, the proximate or the nearest or the closest cause should be taken into consideration to decide the liability of the insurer. The principle states that to find out whether the insurer is liable for the loss or not, the proximate (closest) and not the remote (farest) must be looked into.

For example:- A cargo ship's base was punctured due to rats and so sea water entered and cargo was damaged. Here there are two causes for the damage of the cargo ship - (i) The cargo ship getting punctured because of rats, and (ii) The sea water entering ship through puncture. The risk of sea water is insured but the first cause is not. The nearest cause of damage is sea water which is insured and therefore the insurer must pay the compensation. However, in case of life insurance, the principle of Causa Proxima does not apply. Whatever may be the reason of death (whether a natural death or an unnatural death) the insurer is liable to pay the amount of insurance.

7. Principle of loss minimization

• Under this principle it is the duty of the insured to take all possible steps to minimize the loss to the insured property on the happening of uncertain event. According to the Principle of Loss Minimization, insured must always try his level best to minimize the loss of his insured property, in case of uncertain events like a fire outbreak or blast, etc. The insured must take all possible measures and necessary steps to control and reduce the losses in such a scenario. The insured must not neglect and behave irresponsibly during such events just because the property is insured. Hence it is a responsibility of the insured to protect his insured property and avoid further losses.

For example :- Assume, Mr. Arvind's house is set on fire due to an electric short-circuit. In this tragic scenario, Mr. Arvind must try his level best to stop fire by all possible means, like first calling nearest fire department office, asking neighbours for emergency fire extinguishers, etc. He must not remain inactive and watch his house burning hoping, "Why should I worry? I've insured my house."

DIFFERENTIATION INSURANCE AND GUARANTEE

Insurance is a contract of indemnity whereby Insurer agrees to indemnify, or pay, the insured for certain types of loss while in a contract of guarantee, one party agrees to act on behalf of another should that second party default. In plain terms, this means that if an individual fails to pay her guaranteed debt or to perform some other duty or obligation, the guarantor, the party who has agreed to act on behalf of another will step in to pay or perform the obligation. There are two major differences between insurance and guarantees. One difference is that insurance is a direct agreement between the insurance provider and the policyholder, while a guarantee involves an indirect agreement between a beneficiary and a third party, along with the primary agreement between the principal and beneficiary. A second difference is that insurance policy calculations are based on underwriting and possible loss, while a guarantee is focused strictly on performance or nonperformance. In addition, insurance providers or policyholders can cancel policies with notice, while guarantees often cannot be canceled. The difference between a contract of Insurance and a contract of guarantee are as given below:

In a contract of insurance, there are two parties i.e. insurer and insured. In a contract of Guarantee there are three parties i.e. Main Debtor, Creditor & Surety. Insurance contract is generally Cancellable. Contract of Guarantee is Non-Cancellable Insurance premium is based on the probability and quantum of losses. In contract of business, loss cannot be estimated generally so fee is charged for the guarantee service rendered an insurance contract transfers the risk. There is no transfer of risk in a contract of guarantee

Insurance and wager A contract of Insurance, i.e. life, accident, fire, marine, etc. is not a wager though it is performable upon an uncertain event. It is so because; the principle of insurable interest distinguishes insurance from a wagering contract. Insurable interest is the interest which one has in the safety or preservation of the subject matter of insurance. Where insurable interest is not present in insurance contracts, it becomes a wagering contract and is therefore void. The following are the points of distinction between wagering agreements and insurance contracts.

1. A contract of insurance is a contract to make good the loss of property (or life) of another person against some consideration called premium. A wagering agreement is an agreement to pay money or money's worth on the happening of an uncertain event.

2. The parties have no insurable interest in a wagering agreement. But the holder of an insurance policy must have an insurable interest.

3. In wagering agreement, neither party has any interest in happening or non-happening of an event. But in a contract of insurance, both parties are interested in the subject-matter.

4. Contracts of insurance are contracts of indemnity except life insurance contract, which is a contingent contract. But a wagering agreement is a conditional contract.

5. Contract of insurance are based on scientific and actuarial calculation of risks, whereas wagering agreements are a gamble without any scientific calculation of risk.

6. Contracts of insurance are regarded as beneficial to the public and hence encouraged by the State but wagering agreements serve no useful purpose.

7. A contract of insurance is a valid contract where as a wagering agreement is void being expressly declared by law.

DISCLOSURES

The principle of Uberrimae fidei applies to all types of insurance contracts and is a very basic and primary principle of insurance. According to this principle, the insurance contract must be signed by both parties (i.e insurer and insured) in absolute good faith or belief or trust. The person getting insured must willingly disclose and surrender to the insurer all relevant complete true information regarding the subject matter of insurance. The insurer's liability is voidable (i.e legally revoked or cancelled) if any facts, about the subject matter of insurance are either omitted, hidden, falsified or presented in a wrong manner by the insured. The principle forbids either party to an insurance contract, by non-disclosure or mis-representation of a material fact, which he knows or ought to know, to draw the other into the bargain, from his ignorance of that fact and his believing the contrary. The duty of the utmost good faith is implied in insurance contracts because they are entered into by parties who have not the same access to relevant information. In this, they differ from contracts of sale to which the maxim caveat emptor (let the buyer beware) applies. Although the duty rests upon both parties, it is the duty of the proposer which needs to be discussed in some detail for he usually has the advantage of knowing most of the particulars relating to the subject-matter. Until a definite offer to enter into an insurance contract has been unconditionally accepted the duty of the utmost good faith must be strictly observed. The obligation arises again prior to each renewal and, to a limited extent, when the insured desires an alteration in the policy. In the latter case, he must inform the insurer of any fact’s material to the alteration.

MATERIAL FACTS

Material fact is every circumstance or information, which would influence the judgment of a prudent insurer in assessing the risk. Or Those circumstances which influence the insurer’s decision to accept or refuse the risk or which affect the fixing of the premium or the terms and conditions of the contract, must be disclosed. A material fact is one which would have influenced the judgment of a prudent insurer in deciding whether he would accept the risk in whole or in part and, if so, at what amount of premium. The materiality of a fact depends upon the application of this test to the particular circumstances of the case as at the date that the fact should have been communicated. Material facts may have a bearing on the physical hazard or on the moral hazard, or they may show that if a loss occurs the insurer's liability is likely to be greater than would normally be expected.

FACTS, WHICH MUST BE DISCLOSED

i. Facts, which show that a risk represents a greater exposure than would be expected from its nature e.g., the fact that a part of the building is being used for storage of inflammable materials.

ii. External factors that make the risk greater than normal e.g. the building is located next to a warehouse storing explosive material.

iii. Facts, which would make the amount of loss greater than that normally expected e.g. there is no segregation of hazardous goods from non-hazardous goods in the storage facility.

iv. History of Insurance (a) Details of previous losses and claims (b) if any other Insurance Company has earlier declined to insure the property and the special condition imposed by the other insurers; if any.

v. The existence of other insurances.

vi. Full facts relating to the description of the subject matter of Insurance

EXAMPLES OF MATERIAL FACTS

(a) In Fire Insurance: The construction of the building, the nature of its use i.e. whether it is of concrete or Kucha - having thatched roofing and whether it is being used for residential purposes or as a godown, whether firefighting equipment is available or not.

(b) In Motor Insurance: The type of vehicle, the purpose of its use, its age (Model), Cubic capacity and the fact that the driver has a consistently bad driving record.

(c) In Marine Insurance: Type of packing, mode of carriage, name of carrier, nature of goods, the route.

(d) In Personal Accident Insurance: Age, height, weight, occupation, previous medical history and occupation especially if it is likely to increase the chance of an accident. Proclivity of substance abuse has to be disclosed as well- eg. alcohol or drug addiction.

(e) Burglary Insurance: Nature of stock, value of stock, type of security precautions taken. The above is just indicatory of the type of material facts that must be disclosed. Details of previous losses is a material fact that has to be disclosed in all cases.

FACTS, WHICH NEED NOT BE DISCLOSED

(a) Facts of Law: Ignorance of law is not excusable - everyone is deemed to know the law. Overloading of goods carrying vehicles is legally banned. The transporter cannot take shelter behind the excuse that he was not aware of this provision; in the event of an accident.

(b) Facts which lessen or diminishes the Risk: The existence of a good fire fighting system in the building.

(c) Facts of Common Knowledge: The insurer is expected to know the areas of strife and areas susceptible to riots and of the process followed in a particular trade or Industry. Any fact which is known or which, by law, may be presumed to be known to the insurer the insurer is presumed to know matters of common notoriety or knowledge, and matters which an insurer, in the ordinary course of his business, ought to know.

(d) Facts which could be reasonably discovered: For e.g.the previous history of claims which the Insurer is supposed to have in his record.

(e) Facts which the insurer's representative fails to notice: In burglary and fire Insurance it is often the practice of Insurance companies to depute surveyors to inspect the premises and in case the surveyor fails to notice hazardous features and provided the details are not withheld by the Insured or concealed by him them the Insured cannot be unless inquiry is made, it is not necessary to disclose the following facts. Any fact which it is superfluous to disclose by reason of an express or implied condition.

(f) Any fact as to which information is waived by the insurer.

(g) Any fact as to which insurer is given sufficient information to put him on inquiry.

TIME OF DISCLOSURE

The duty of disclosure must be observed, from the time of submission of proposal and continued throughout the negotiations until the contract is concluded. Any material fact, therefore, which, at any stage of negotiations, comes to the knowledge of the proposer assured, including any alteration of circumstances which brings into existence of material fact or in consequence of which a fact previously immaterial becomes material, must be at once communicated to the users.

EFFECT OF NON-DISCLOSURE

Where there has been non-disclosure, whether innocent or fraudulent, sometimes called concealment the contract is voidable at the option of the insurer. This is the position where the matter is not dealt with by a policy condition. The ground is usually covered by a policy condition which may do no more than state the common law rule.

REPRESENTATIONS

Representations are statements made during the negotiations with the object of inducing the other party to enter into the contract: they must be distinguished from statements which are introduced into the contract, and upon the truth of which the validity of the contract is made to depend. Representations may be as to a matter of fact, and, if material must be substantially correct. Where there has been misrepresentation it is necessary to decide whether it was fraudulent or innocent. A fraudulent misrepresentation is one which was known to be false; or which was made without belief in its truth, or recklessly, careless whether it was true or false. Fraudulent misrepresentation of a material fact entitles the insurer to avoid the policy. Every material fact which the insured ought to know in the ordinary course of business must be stated; an innocent misrepresentation of such a fact would entitle the insurer to avoid the policy. This must be so, otherwise the duty to disclose material facts and to state them accurately would not be correlative.

ACTIVE AND PASSIVE DUTY OF DISCLOSURE

The question here is what method is used to acquire the material information. Two different approaches are used in this respect. The first - an “active” duty of disclosure, and the second approach is characterized as a “passive” duty of disclosure. The former argues that the duty to assess what information is material for the insurer rests with the person effecting the insurance.

On the other hand, a passive duty of disclosure implies that the insurer will have to define what information is material through a questionnaire. A passive duty of disclosure implies that information not asked for is not material. The common law systems seem mainly to apply an active duty of disclosure, but elements of a passive duty of disclosure is found in some countries in the form of proposals.

MORAL HAZARDS

Moral hazard is a situation in which one agent decides on how much risk to take, while another agent bears (parts of) the negative consequences of risky choices. The person who buys insurance is protected against monetary damages. Therefore, he may engage in more risky behavior than if he has to bear the risk himself.

Moral hazard can arise in the insurance industry when insured parties behave differently as a result of having insurance. There are two types of moral hazard in insurance: ex ante and ex post Ex-Ante Moral Hazard - Ed the Aggressive Driver: Ed, a driver with no auto insurance, drives very cautiously because he would be fully responsible for any damages to his vehicle. Ed decides to get auto insurance and, once his policy goes into effect, he begins speeding and making unsafe lane changes. Ed's case is an example of ex-ante moral hazard. As an insured motorist, Ed has taken on more risk than he did without insurance. Ed's choice reflects his new, reduced liability.

Ex-Post Moral Hazard - Marie and Her Allergies: Marie has had no health insurance for a few years and develops allergy symptoms each spring. This winter she starts a new job that offers insurance and decides to consult a physician for her problems. Had Marie continued without insurance, she may never have gone to a doctor. But, with insurance, she makes an appointment and is given a prescription for her allergies. This is an example of ex-post moral hazard, because Marie is now using insurance to cover costs, she would not have incurred prior to getting insurance. Insurers try to decrease their exposure by shifting a portion of liability to policyholders in the form of deductibles and co-payments. Both represent the amount of money a policyholder must pay before the insurance company's coverage begins. Policyholders can often opt for lower deductibles and co-payments, but this will raise their insurance premiums.

SCHOOL OF MANAGEMENT STUDIES

UNIT – 5 – Banking and Insurance Management – SBAA7001

UNIT 5 INSURANCE INTERMEDIAREIS AND REGULATIONS

Insurance Intermediaries – Market Players and their Roles: Agents, Brokers, Surveyors &Loss Assessors; Insurance Act – Insurance Regulatory and Development Act, Powers and Functions of IRDA, Regulations and Guidelines issued by IRDA.

Concept of intermediaries

A basic definition defines an intermediary as 'action between two parties - mediatory' or 'situated or occurring between two things - intermediate'. The latter form refers more to a position within a process or level of achievement. The former, by contrast, refers to an intermediary as an agent in some form, as 'one who acts between others - a do-between or mediator', or as 'something acting between things persons or things'. As actors then, what intermediaries do is mediate, they work in-between, make connections, enable a relationship between different persons or things.

Indeed, in common parlance the meaning implied by the concept intermediary tends to refer to a neutral player trying to mediate between different sets of interests. The assumption of neutrality is however, problematic. Rather than focus on everything as an intermediary, the interesting question is to ask in what ways, where, when and how particular things, people, organisations etc. are/ become defined as 'intermediaries. Further still, there is the question of the active role that intermediaries play in defining the relationship between other actors.

In Insurance industries, an insurance intermediary is a person or a company that helps you in buying insurance. Insurance intermediaries facilitate the placement and purchase of insurance, and provide services to insurance companies and consumers that complement the insurance placement process. Traditionally, insurance intermediaries have been categorized as either insurance agents or insurance brokers.

Role of Intermediaries in Insurance Industry

As players with both broad knowledge of the insurance marketplace, including products, prices and providers, and an acute sense of the needs of insurance purchasers, intermediaries have a unique role – indeed many roles – to play in the insurance markets in particular and, more generally, in the functioning of national and international economies.

Intermediary activity benefits the overall economy at both the national and international levels: The role of insurance in the overall health of the economy is well-understood. Without the protection from risk that insurance provides, commercial activities would slow, perhaps grinding to a halt, thus stunting or eliminating economic growth and the financial benefits to businesses and individuals that such growth provides.

The role of insurance intermediaries in the overall economy is, essentially, one of making insurance – and other risk management products – widely available, thereby increasing the positive effects of insurance generally – risk-taking, investment, provision of basic societal needs and economic growth.

There are several factors that intermediaries bring to the insurance marketplace that help to increase the availability of insurance generally:

Innovative marketing - Insurance intermediaries bring innovative marketing practices to the insurance marketplace. This deepens and broadens insurance markets by increasing consumers' awareness of the protections offered by insurance, their awareness of the multitude of insurance options, and their understanding as to how to purchase the insurance they need.

Dissemination of information to consumers - Intermediaries provide customers with the necessary information required to make educated purchases/ informed decisions. Intermediaries can explain what a consumer needs, and what the options are in terms of insurers, policies and prices. Faced with a knowledgeable client base that has multiple choices, insurers will offer policies that fit their customers' needs at competitive prices.

Dissemination of information to the marketplace - Intermediaries gather and evaluate information regarding placements, premiums and claims experience. When such knowledge is combined with an intermediary's understanding of the needs of its clients, the intermediary is well-positioned to encourage and assist in the development of new and innovative insurance products and to create markets where none have existed. In addition, dissemination of knowledge and expansion of markets within a country and internationally can help to attract more direct investment for the insurance sector and related industries.

Sound competition - Increased consumer knowledge ultimately helps increase the demand for insurance and improve insurance take-up rates. Increased utilization of insurance allows producers of goods and services to make the most of their risk management budgets and take advantage of a more competitive financial climate, boosting economic growth.

Spread insurers' risks - Quality of business is important to all insurers for a number of reasons including profitability, regulatory compliance, and, ultimately, financial survival. Insurance companies need to make sure the risks they cover are insurable – and spread these risks appropriately – so they are not susceptible to catastrophic losses. Intermediaries help insurers in the difficult task of spreading the risks in their portfolio. Intermediaries work with multiple insurers, a variety of clients, and, in many cases, in a broad geographical spread. They help carriers spread the risks in their portfolios according to industry, geography, volume, line of insurance and other factors. This helps insurers from becoming over-exposed in a particular region or a particular type of risk, thus freeing precious resources for use elsewhere.

Reducing costs - By helping to reduce costs for insurers, broker services also reduce the insurance costs of all undertakings in a country or economy. Because insurance is an essential expense for all businesses, a reduction in prices can have a large impact on the general economy, improving the overall competitive position of the particular market. Of course, the insurance cycle of "hard" and "soft" markets can have a significant impact on the benefits – both good and bad – of increased availability. Generally, however, increased availability benefits the consumer by leading to product competition, price competition, and improved services. By reducing insurance costs across markets, intermediaries make an important contribution to improving the economic conditions in a country.

Market Players and their Roles

There are many market players in insurance industries i.e.

a. Agents

b. Brokers

c. Surveyors & Loss Assessors

d. Health Third Party Administrators.

The role of various players of insurance market is being discussed hereby:

(a)Insurance Agent

Insurance agent is the salesperson of the insurer. An agent is one who is licensed under Section 42 of the Insurance Act, 1938, and who receives or agrees to receive payment by way of commission or remuneration in consideration of his soliciting or procuring insurance business including business relating to the continuance, renewal or revival of policies of insurance.

[Sec. 2 (10) of Insurance Act, 1938.] In simple words, we can say that an insurance agent is a licensed representative of the insurer who agrees to work for the insurer in exchange of commission or remuneration. He plays a promotional job.

Functions of Insurance Agent:

To solicit and procure new business: An agent is bound to obtain certain specified amount of new business as required under the rules. He should always make effort in getting new insurance proposals beyond his prescribed limit.

To conserve the present business: In addition to procuring new business, he should ensure the continuation of the policies already issued and prevent them from lapsing on account of default in the payment of premium.

Assist in selection of suitable policy: The agent should give proper guidance and help to the prospects in selection of a suitable policy, keeping in view the needs of the proposed by guiding him.

To enquire into full details of prospects : It is an important duty of the insurance agent to enquire into all the requisite information from the prospective insured. This becomes necessary to ascertain the extent of risk.

Inform the agency about the factors which can cause damage to insured : It is the duty of an agent to inform the agency about all the related information which can influence the insurance policy by any means.

Assuring the age of insured : It is the duty of an agent to assure date of birth of an insured at the time of starting the policy. This helps in future settlements of policies.

To motivate the policy holders to pay premium in time: It is the duty of an agent to inform the insured to pay premium in time and get benefits of payments by avoiding penalties applicable in late payments.

To prevent the policy from lapsing: Agent should inform the disadvantages of policy lapse to the insured.

Inform the insured for appointing nominee(s): It is the duty of an agent to make sure that the nominees column is filled by the insured. This helps in future settlements of policies without any ambiguity.

To prepare the necessary documents : This proposer has to submit other important documents like birth certificate, medical certificate, etc. The agent can help the proposer by guiding him.

Other important duties of an agent:

1. Inform about the policies to the insurer.
2. By knowing the requirements of prospects, providing him the best suitable policy.
3. Working hard with honesty.
4. Introducing himself as an insurance agent, and if asked, to show his I.D.
5. If asked by the insured, telling him about the rate of commission.
6. Calculating the amount of premium which is payable by the insured.
7. Explaining the details of insurance application form to the prospect.
8. Informing the prospects about the refusal of insurance application by the insurance agency.
9. Following the rules and regulations of insurance authority.
10. Providing insurance bond to the insured within 45 days.

Role of an Insurance Agent

An insurance agent represents the insurer with whom he or she is attached. He solicits or procures insurance business only for such insurer. The responsibilities of an insurance agent broadly include the following:

(a) Perform Need analysis for the customer – The agent is expected to sell the products of the insurance company, which suit the needs of the customer. For this purpose he has to analyse the needs of the customer, such as Insurance protection for family, Asset protection needs, Children's marriage or education needs, Health insurance, Pension etc. Depending on the needs and the stage of the life cycle of the customer, the appropriate product of the insurer which suits the customer is recommended

(b) Explain the product benefits, premiums, exclusions and other terms and conditions so that the customer can take an informed decision

(c) Assist the customer in getting the requisite documents for the purpose of seeking an insurance cover and clarify the doubts of the customer in the proposal form filling process

(d) Bring to the notice of the insurer any adverse habits of the customer which will have a bearing on the insurer's decision to accept a risk

(e) Inform the customer about the decision of the insurer to issue a policy or otherwise

(f) Provide assistance to customer at various stages of policy servicing and when a claim is made

Qualification and training

Most insurance companies and independent firms prefer to hire young graduates who hold degrees in business or economics. Generally, companies do not prefer non-graduates for this post. However, there are certain exceptions to this condition. In case a non-graduate has previous work experience or has proven expertise in any business areas can be employed as an insurance agent.

Experience in sociology and public speaking can prove as a benefit for the candidate to improve their sales skills. Proficiency in software and computer are significantly essential for an insurance agent as an educational, advertising, and communicational tool.

While the criteria to become an insurance agent may differ from one company to another, all companies demand a candidate to acquire a license from IRDAI. To receive a license, applicants need to clear an examination and undergo pre-licensing training related to insurance practicing and laws.

Skills

A candidate who is conducting a job search in the insurance field needs to possess a specific skill set. Insurance is all about marketing and selling the right products to the clients.

This type of job requires a candidate to have excellent communication skills, need to be well-organized and possess the ability to analyse the customer's requirements. This will help an insurance agent to suggest the insurance policy that will fulfill their insurance needs effectively.

Individuals interested in becoming insurance agents will need to undertake training with an insurance company regarding its products and insurance regulations and laws.

An insurance agent needs to have the ability to demonstrate and listen carefully to the prospect. He/she should have the ability to take complex information and convert it into simple language that anyone can understand. This is another skill that most insurance companies look into a candidate.

Insurance agent's functions are mainly based on demonstrating, communicating, and convincing powers. An insurance agent with proficiency in these features has enormous scope to make a successful career in this field.

TYPES OF INSURANCE AGENTS:

The following are the different types of Insurance Agents recognized under the Regulations:

(a) Individual Agent

(b) Corporate Agent

(c) Micro Insurance Agent

Individual Agents

IRDA (Licensing of Insurance Agents) Regulations, 2000 as amended from time to time, contains provisions relating to licensing of individual Insurance Agents. The following are the different types of licences issued within the Regulations:

(a) Direct Life

(b) Direct Non Life

(c) Composite Licence (both Life and Non-Life)

The following are the pre-requisites for a candidate intending to get a licence issued (common for all types of agents):

(a) **Minimum qualifications:** The minimum qualifications prescribed are a pass in 12th standard or equivalent examination conducted by a recognised Board/Institution. This condition is relaxed to a pass in 10th standard for applicants residing in a place where the population is not less than 5,000 ('Rural agents')

(b) The applicant must not suffer from the following disqualifications:

a. That the applicant is not minor

b. That he is not found to be of unsound mind by a Court of competent jurisdiction

c. That he has not been found guilty of criminal misappropriation or criminal breach of trust or cheating or forgery or an abetment of or an attempt to commit any offence by a Court of competent jurisdiction and five years have not elapsed from the date of conviction

d. That he has been found guilty of or has knowingly participated in or connived at any fraud, dishonesty or misrepresentation against an insurer or an insured during the course of:

(i) Any judicial proceeding relating to any policy of insurance (or)

(ii) Winding up of an insurance company (or)

(iii) In the course of investigation of affairs of an insurer

(e) That he does not violate the code of conduct prescribed under the Regulations

(c) **Practical Training:** The applicant shall undergo a minimum of 50 hours practical training on insurance related matters in life or general insurance business, as the case may be, spreading to 1 to 2 weeks. Where the application is for a composite licence, the training shall be 75 hours spread over 3 to 4 weeks covering both life and general insurance subjects. Where the applicant holds special qualifications such as membership of Institute of Chartered Accountants of India, Institute of Cost and Works Accountants of India, Institute of Company Secretaries of India, Insurance Institute of India or the Institute of Actuaries of India or a Masters degree in Business Administration of any institution recognised by Central Government or State Government, it is sufficient if the training is undergone for 25 hours (35 hours if the licence is composite). The training can be undergone in any of the IRDA accredited training institutions

(d) **Examination:** Every applicant shall undergo a pre-recruitment examination in life or general insurance business or both, as the case may be, conducted by the Insurance Institute of India or any other body authorised by IRDA.

(e) **AML & ULIP training:** In addition to the above, the insurer with whom the agent is attached provides a special training on Anti money laundering (under the IRDA's Anti money laundering Guidelines dated 31 March 2006) for all Insurance Agents. Training in Unit Linked Insurance Products (ULIP) is compulsory for life insurance agents before they are allowed to sell ULIPs on behalf of a life insurer (under the IRDA (Linked Insurance Products) Regulations, 2013)

(f) Payment of fees of Rs.250 along with the application for grant of licence enclosing proof of age, qualifications, training and examination.

Renewal of licence

A licence is issued for a period of three years at a time. At the end of the third year, the licence is required to be renewed. The following are the conditions for renewal of licence:

(a) Completion of practical training for 25 hours for Life or General insurance, as the case may be or 50 hours for renewal of composite agency licence

(b) Payment of fees of Rs.250 towards renewal of licence. If the application for renewal does not reach atleast 30 days before the due date for renewal, an additional fee of Rs.100 by way of penalty is payable. If the application for renewal reaches after the expiry of licence, IRDA may consider the application for renewal upon imposition of a penalty of Rs.750.

(c) Maintenance of a minimum persistency of 50% during the licence period (as per IRDA's persistency guidelines.

(d) The Agent does not suffer from any of the disqualifications mentioned in the previous section

(e) Renewal training on Anti-money laundering as may be prescribed by the insurer from time to time

Authorization to sell for one insurer at a time

A licence issued under the provision of the above Regulations entitles an Insurance Agent to sell on behalf of one life insurer or one General insurer at a time. An identity card is issued by the concerned Insurer for this purpose. An Agent is entitled to change insurer but has to follow the process laid down in IRDA's circular on issue of a 'No objection Certificate" by the insurers.

Corporate Insurance Agent

Corporate entities represent an **insurance** company and sell its policies. ... When a bank becomes the **corporate agent** of an **insurance** company it is referred to as a bancassurance arrangement or partnership. Banks offer **insurance** policies to their customers based on their knowledge of their situation and needs.

Licensing of Corporate Agents

The IRDA (Licensing of Corporate Agents) Regulations, 2002 provides the licensing framework for Corporate Agents similar to the Regulations applicable to Individual Agents. The Corporate Agents regulations recognize agents who are one of the following entities (as against individual agents who are licensed under the IRDA (Licensing of Insurance Agents) Regulations, 2002):

(a) Firm

(b) Company under the Companies Act, 1956

(c) Banking company

(d) Co-operative society

(e) Panchayat or local authority

(f) Non-Government organisation

The licence is issued to the entity as against the individual under licensing of individual agents. However, thepersons who are authorised to sell on behalf of a Corporate Agent will have to undergo the training and examination requirements similar to that of an Individual agent.

The Corporate agent shall have the following persons at the minimum as per the Regulations:

(a) Corporate Insurance Executive ('CIE') (b) Specified Persons ('SP') A Corporate Insurance Executive is the Director or Partner or one or more of its officers or employees so designated by it (where the applicant is a Company or a Firm). Where the applicant is any other person, the Chief Executive or one or more of his employees designated by him shall be the CIE. In either case, the CIE shall possess the minimum qualifications, undergo the practical training and pass the required examination. A Specified Person is responsible for soliciting or procuring insurance business on behalf of the Corporate Agent entity. He may be a Director or a Partner or one or more of its officers or other employees so designated by the Corporate Agent. The individual desirous of acting as a Specified Person shall also possess the requisite qualifications, undergo the practical training and pass the examination. A Certificate is issued to a Specified Person which authorises him to solicit or procure insurance business on behalf of the Corporate Agent. There may be as many number of Specified Persons as the Corporate Agent requires depending upon the business requirements. The minimum qualifications, practical training and examination requirements are similar to that of an individual agent. A Corporate Agent is also allowed to act for only one life insurer (Direct-Life) or one general insurer (Direct-Non-Life) or Composite Corporate Agent (one Life and one General at a time)

As per the IRDA guidelines on Corporate Agents, dated 14 July 2005, two types of Corporate Agents are recognized:

(A) Exclusive Corporate Agents – i.e. those entities whose primary activity is solicitation or procuration of insurance business. Such entities shall be Public Limited companies under the Companies Act, 1956, with a minimum paid up capital of Rs.15 lakhs deposited in a Scheduled Commercial Bank. Further entities belonging to Banking or Insurance Groups alone are allowed to form Exclusive Corporate Agencies

(B) Non-exclusive Corporate Agents – entities which are already engaged in some other business and would like to take up insurance agency as a subsidiary activity. Further a Group to which the applicant Corporate Agent belongs to, can be granted only one corporate agency licence. In other words, any proposal from an applicant, some of whose group entities are already engaged in insurance business, such as corporate agent, broker, insurer etc., shall not be normally granted a corporate agency licence. IRDA does not normally grant any exception unless the entities are licensed by Reserve Bank of India with substantial client base or otherwise have assets, turnover or net worth of Rs.15 Crores.

Requirements for becoming a Corporate Agent:

(a) Formation or existence of an entity as required under the Regulations as above

(b) Identification of persons possessing the minimum qualifications to become a CIE or SP (a minimum of 1 CIE and 2 SPs are normally insisted by IRDA at the time of licensing). The actual number of persons will depend on the business plan of the applicant corporate agent. CIEs or SPs can also be changed or added (in addition to minimum) subsequently

(c) Document evidencing constitution of the Corporate agent entity (e.g. Memorandum and Articles ofAssociation) shall contain “procuring or solicitation of insurance business” as one of the main objects

(d) Proof of CIE and SPs having undergone the practical training and passed the required examination

(e) Either CIE or one of the SPs must possess one of the following additional qualification:

(i) An Associate/Fellow of the Insurance Institute of India, Mumbai.

(ii) an Associate/Fellow of the Institute of Chartered Accountants of India, New Delhi; with diploma in Insurance and Risk Management.

(iii) an Associate/Fellow of the Institute of Costs and Works Accountants of India, Calcutta;

(iv) an Associate/Fellow of the Institute of Company Secretaries of India, New Delhi;

(v) an Associate/Fellow of the Actuarial Society of India, Mumbai;

(vi) possessing Certified Associate ship of Indian Institute of Bankers (CAIIB)

(vii) MBA (Two year) Course / PG Diploma (One year) course in Insurance from Amity School of Insurance & Actuarial Science, Noida

(viii) PG Diploma (One year) course in Insurance from Institute of Insurance and Risk Management, Hyderabad

(ix) MBA (Two year) course in Insurance from National Insurance Academy, Pune

(x) PGMBA (Two Year) course in Insurance from National Law University, Jodhpur

(xi) PGMBA (Two year) course in Insurance from MET, Mumbai

(xii) MBA (Two year) course in Insurance from Birla Institute of Management Technology, Noida the persons with above qualifications (except at (a) shall undergo a “Workshop for Insurance executives” at National Insurance Academy, Pune or Insurance

Institute of India, Mumbai or Institute of Insurance and Risk Management, Hyderabad as prescribed by the Authority.

(f) In the case of exclusive Corporate Agencies, proof of formation of a public company, injection of a capital of Rs.15 lakhs and depositing the money into a Bank

(g) Fee of Rs.250 for issue of licence to the Corporate Agent and Rs.500 for issue of Certificate for each Specified person Renewal of licence A license is issued for a period of 3 years and shall expire at the end of the term, unless renewed. The annual fee to the Authority in such manner as may be specified by the regulations for renewal of an individual agency license. The conditions for renewal of licence for a corporate agent is similar to that of an individual agent, including maintenance of a minimum persistency of 50%

Micro Insurance Agent

Micro insurance Agents are a special category of insurance agents who support financial inclusion, i.e. the distribution of financial services at an affordable cost to the masses. Micro insurance contracts are typically low sum assured contracts which provide for the sum assured to be paid either on death – both natural and accidental, or an Endowment (which also provides a sum assured on maturity in addition to death) or a health insurance.

Only a Non-Governmental organisation or a Self Help Group Micro Finance Institutions or Associations not formed for Profit are entitled to become Micro Insurance Agents. Such Agents can distribute the products of one life insurer or one general insurer or both. A Micro insurance agent shall employ Specified persons with the prior approval of the Insurer to distribute the micro insurance products on its behalf. All the Micro insurance agents and their Specified persons shall be imparted 25 hour training by the insurer in local vernacular language in the areas of insurance selling, policyholder servicing and claims administration.

A Micro insurance agent can sell only a Micro insurance product and not any other type of insurance products. However an Agent who is licensed to sell all products of an insurer can sell the Micro insurance products of such insurer, if any. An Insurance Broker who can sell any product of any insurer, can sell Micro insurance products of any insurer as well.

All Micro insurance policies may be reckoned for the purpose of fulfilment of social obligations of an insurer pursuant to the provisions of the Insurance Act and Regulations. Where a micro insurance policy is issued in a rural area and falls under the definition of social sector, such policy may be reckoned for both under rural and social sector obligations as well.

Insurance Broker

Regulation 2(i) of the IRDA (Insurance Brokers) Regulations, 2002, defines Insurance Broker as a person forthe time being licensed by the Authority under Regulation 11, who for remuneration arranges insurance contracts with insurance companies and/or reinsurance companies on behalf of his clients. Licensing of Insurance Brokers Every Insurance Broker shall possess a valid and subsisting licence to act as an Insurance Broker issued by IRDA. The framework for licensing of an Insurance Broker is similar to that of a Corporate Agent. However, as we have seen earlier a Broker differs from an Agent in the sense that a Broker represents customers interests and is required to select the best product amongst all insurance companies, while an agent represents an insurer at any point in time (one in life and one in general insurance) and will present the product of only such insurer(s) with whom the agent is attached with.

Categories of Insurance Brokers

(a) Direct Broker (Life)

(b) Direct Broker (General)

(c) Direct Broker (Life & General)

(d) Reinsurance Broker (Reinsurance Life or General)

(e) Composite Broker (Life and/or General + Reinsurance)

A Direct Broker is authorised to recommend the products of any of the life insurance companies or general insurance companies to their clients, as the case may be.

A Reinsurance broker arranges for reinsurance contracts between direct insurers and reinsurance companies.

Reinsurance is a contract under which insurance companies can pass on the risk they assume under the policies issued by them, to yet another insurance company (called reinsurer). Therefore, the insurance company which issues the policy becomes the Policyholder under the reinsurance contract entered into with a reinsurer.

A broker can be an intermediary who can arrange reinsurance contracts with reinsurance companies.

Except for GIC, the National Reinsurer, all the other reinsurance companies doing business in India are located abroad. Therefore the role of reinsurance brokers in getting a best deal for insurance companies cannot be undermined.

A Composite Broker is one who arranges for both insurance contracts both for retail and institutional clients as a Direct Broker as well as for insurance companies as a reinsurance broker.

Role of an Insurance Broker Regulation 3 of the IRDA (Insurance Brokers) Regulations, 2002 summarises the functions of a Direct Broker:

(a) Since a Broker represents a client, he is expected to obtain detailed information on client's business and risk management philosophy and familiarise himself with the client's business

(b) Render proper advice to the client in selecting the appropriate insurance as well as terms of insurance

(c) Possessing a detailed knowledge of insurance markets to be in a position to advice his client

(d) Submitting quotation received from insurance companies for consideration of a client

(e) Providing the information required about the client or the subject matter to be insured, to enable insurer to properly assess the risk and give a premium quotation

(f) Updating customer about the progress of the proposal submitted and providing written acknowledgements

(g) Assisting clients in paying premiums under Section 64VB of the Insurance Act, 1938

(h) Assisting clients in negotiation of claims and maintenance of claim records

Regulation 4 lists down the functions of a Reinsurance Broker:

(a) Familiarising himself about the client's business and risk retention philosophy

(b) Maintaining clear records of insurer to assist reinsurers

(c) Rendering advice based on technical data on the reinsurance covers available in the international insurance and the reinsurance markets

(d) Maintaining a database of available reinsurance markets including solvency ratings of individual reinsurers

(e) Rendering consultancy and risk management services for reinsurance

(f) Selecting and recommending a reinsurer or a group of reinsurers

(g) Negotiating with a reinsurer on client's behalf

(h) Assisting in the case of commutation of reinsurance contracts placed with them

(i) Acting promptly on instructions from a client and providing it written acknowledgement and progress reports

(j) Collecting and remitting premiums and claims within such time as agreed upon

(k) Assisting in the negotiation and settlement of claims

(l) Maintaining proper records of claims

(m) Exercising due care and diligence at the time of selection of reinsurers and international reinsurance brokers having regard to their respective security rating and establishing respective responsibilities at the time of engaging their services

The person entitled to become an Insurance Broker can be an individual, firm, a Company under the Companies Act, 1956; a Co-operative Society registered under the Co-operative Societies Act, 1912 or under any other law for the registration of Co-operative Societies or such other persons as IRDA recognises to act as an insurance broker.

Normally, IRDA encourages only Companies to take up Insurance Broking.

Requirements for licensing of an Insurance Broker

(a) Application for broking licence, duly filled in and signed by the authorised signatory, along with supporting documents

(b) Memorandum and Articles of Association shall contain "solicitation or procuring insurance business as an Insurance Broker" as the main object

(c) Appointment of a Principal Officer who is the Director or the Chief Executive Officer appointed exclusively to carry out the functions of an insurance broker. Such a Principal Officer is subject to minimum qualifications as prescribed under the Regulations and shall undergo theoretical and practical training from IRDA accredited training institutes and has passed the examination conducted by National Insurance Academy, Pune or any other examining body.

Atleast two employees of the applicant entity who have the minimum qualifications as prescribed by the Regulations and has undergone the practical training and passed the examination as mentioned above. Only such employees are authorised to solicit or procure insurance business on behalf of the insurance broker.

(d) An insurance broker may have as many numbers of authorized employees fulfilling the above conditions, as required depending on the business plan.

(e) The entity formed shall be solely engaged in the business of insurance broking and no other business

(f) The non-resident equity in insurance broking entity shall not exceed 26%

(g) Minimum capital requirements for the broking entity: Direct Broker `50 lakhs Reinsurance Broker `200 lakhs Composite Broker `250 lakhs

(h) A minimum of 20% of the initial capital shall be kept in a Bank deposit which shall not be released without the prior approval of IRDA

(i) A professional indemnity insurance policy shall be taken by the broker as prescribed in the Regulations. IRDA may suitable cases allow a newly licensed broker to product the policy within 15 months from the date of issue of original licence

(j) Payment of Registration fee as follows: Category of Insurance Broker Amount of Registration fee payable Direct Broker `20,000 Reinsurance broker `25,000 Composite Broker `40,000

(k) Qualifications and Disqualifications The Principal Officer and each of the employees authorised to sell on behalf of the Insurance Broker shall possess one of the following minimum qualifications:

(a) Bachelor’s or Masters Degree in arts, science or social sciences, engineering or its equivalent, law or its equivalent

(b) Master's Degree in Business Administration or its equivalent from any institution or university

(c) Associate or Fellow of the Insurance Institute of India or Institute of Risk Management or Institute of Chartered Accountants of India or Institute of Cost and Works Accountants of India or Institute of Company Secretaries of India or Institute of Actuaries of India or a Certified Associate of the Indian Institute of Bankers

(d) Such other qualification as may be prescribed by IRDA the Insurance Broker shall not suffer from any of the disqualifications which are similar to the disqualifications prescribed for an individual agent

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(a) Bachelor's or Masters Degree in arts, science or social sciences, engineering or its equivalent, law or its equivalent

(b) Master's Degree in Business Administration or its equivalent from any institution or university

(c) Associate or Fellow of the Insurance Institute of India or Institute of Risk Management or Institute of Chartered Accountants of India or Institute of Cost and Works Accountants of India or Institute of Company Secretaries of India or Institute of Actuaries of India or a Certified Associate of the Indian Institute of Bankers

(d) Such other qualification as may be prescribed by IRDA The Insurance Broker shall not suffer from any of the disqualifications which are similar to the disqualifications prescribed for an individual agent

Annual Fee Every Broker shall pay an Annual Licence Fee as follows:

Category of Insurance Broker	Amount of annual license fee payable per annum
Direct Broker	A sum calculated at the rate of 0.50 per cent of the remuneration earned in the preceding financial year subject to minimum of INR 25000 and maximum of INR 100000.
Reinsurance broker	A sum calculated at the rate of 0.50 per cent of the remuneration earned in the preceding financial year subject to minimum of INR 75000 and maximum of INR 300000
Composite Broker	A sum calculated at the rate of 0.50 per cent of the remuneration earned in the preceding financial year subject to minimum of INR 125000 and maximum of INR 500000

Renewal of licence

A licence issued to an Insurance Broker is valid for 3 years unless suspended or cancelled before the expiry of the 3 year period. The licence shall be renewable for a further period of 3 years subject to the following conditions:

(a) Application for renewal has to be submitted 30 days in advance of the date of expiry of licence

(b) Additional fee of Rs.100 in case the application reaches after the 30 days but before the expiry of licence

(c) Additional fee of Rs.750 in case the application reaches after the expiry of the licence for valid reasons to the satisfaction of IRDA

(d) Principal Officer and every employee authorised to sell on behalf of the insurance broker to undergo 25 hours of theoretical and practical training by IRDA accredited training institutes

Difference between Insurance Agent and Insurance Broker

The basic difference between an Insurance Broker and an Insurance Agent is that while an Insurance Broker represents the client, while an Insurance Agent represents the insurance company. As a corollary to the above, an Insurance Broker is licensed to recommend the products of any insurance company, whereas Insurance Agent at any point in time can sell the insurance products of only one insurance company with which he is attached.

Surveyors or a Loss Assessor

A Surveyor or a Loss Assessor is relevant for general insurance business, where assessment of the loss of the subject matter insured is very important for deciding the claim amount. As general insurance contracts are indemnity contracts in nature, the amount paid by the insurance company cannot exceed the amount of actual loss incurred.

The job of the Surveyor or a Loss Assessor is therefore to arrive at the exact amount of loss incurred and his role is critical to a general insurer. Every person who is a student-member of the Institutes of Surveyors and Loss Assessors intending to act as a Surveyor or Loss Assessor is required to be licensed by IRDA before he starts performing his functions for any general insurer. A licence issued for a Surveyor or a Loss Assessor shall be valid for a period of 5 years after which it is required to be renewed.

A Surveyor and Loss Assessor shall be categorized into 3 categories;

The three categories are Licentiate, Associateship and Fellowship which is awarded by the Institute of Surveyors and Loss Assessors. The nature of surveyor or loss assessment work which can be undertaken would depend upon the categorisation. Further IRDA shall also allot the department or the area work for the Surveyor and Loss Assessor from time to time. Requirements for issue of a licence for Surveyor or Loss Assessor Regulation 3 of the Insurance **Surveyors and Loss Assessors (Licensing, Professional and Code of conduct) Regulations, 2000 specify the requirements for issue of a licence:**

(a) He holds a degree in any branch of engineering (or) Post graduate diploma in general insurance issued by Institute of Insurance and Risk Management (or) a Degree in Agriculture (or)

(b) He is a member of the Institute of Chartered Accountants of India or the Institute of Cost and Works Accountants of India (or)

(c) He possesses actuarial qualifications or holds a degree or diploma of any recognised university or an institute in relation to insurance (or)

(d) He holds a diploma in insurance granted or recognised by the Government (or)

(e) He holds such other technical qualifications as prescribed by IRDA (and)

(f) He does not suffer from any of the disqualifications mentioned in section 42(4) Where the entity is a company or a firm, all the directors or partners shall possess one of the qualifications as prescribed above and none of the directors or partners suffer from any of the disqualifications mentioned as above (and)

(g) Payment of fees based on the categorisation of the applicant (and)

(h) Has undergone practical training as a Student-member under a licensed Surveyor and Loss Assessor (who shall be a Fellow or Associate member of the Institute) for a period of 12 months as contained in Chapter VII (persons who have more than 15 years experience in risk management and general insurance are exempt from this training) (and)

(i) Has passed the Surveyor examination conducted by the Insurance Institute of India or such other institute recognised by IRDA (and)

(j) Has undergone the special training provided by the Indian Institute of Surveyors and Loss Assessors for 100 hours for Fellowship, 50 hours for Associate and 25 hours for Licentiate level (and)

(k) He attends seminars and workshops organised by the Institute for a minimum number of seminars, viz., 10 seminars for fellowship, 8 for Associateship and 5 for Fellowship level Where the applicant is a company or firm, all the directors or partners, as the case may be, shall possess one or more of the qualifications specified above and does not suffer form any of the disqualifications mentioned in Section 42D(4) of the Insurance Act, 1938. Atleast 2 Directors or partners shall be members of the institute and shall hold the licence to act as a surveyor and loss assessor. The level of membership or the department to which the directors or partners belong to shall become the level of membership or the department for the company or firm. Employees of the company of the firm, who are licensed as surveyor and loss assessor shall undertake survey only in those areas allotted to them based on the level of membership and the department to which they are eligible as per their individual licence. However this eligibility is subject to the level of membership or the department of the company or the firm (which is dependent on the directors/partners eligibility as above).

The following are the further conditions prescribed:

(a) Foreign equity in the Surveyor and Loss assessor entity shall not exceed 26%

(b) Common directors or partners between two Surveyor and Loss assessor entities prohibited

(c) One Promoter or Subscriber can have only one Surveyor and Loss assessor licence

(d) Main objects clause of the deed of constitution shall contain the activity of “to carry our insurance survey and loss assessment”

(e) Name of the Company or firm shall contain the words “Insurance Surveyors and Loss Assessors”

The Fees payable for issue of licence are as follows:

Sr.No.	Level of membership in the Institute	Individual licence	Corporate licence
1	Fellowship	₹10,000	₹15,000
2	Associateship	₹7,500	₹20,000
3	Licentiate	₹5,000	₹15,000

IRDA, on being satisfied that the applicant is eligible for issue of a licence shall send intimation to the applicant together with an identity card mentioning the particular class or category of general insurance business, namely, fire, marine cargo, marine hull, engineering, motor, miscellaneous and loss of profit, for which the Authority has granted licence.

Role of a Surveyor or Loss Assessor

The primary responsibility of a Surveyor or a Loss assessor is to estimate the liability of the loss incurred by the Policyholder who has taken an insurance cover, to enable the insurance company to arrive at the amount to be indemnified to the Policyholders under the terms of insurance contract. The following are the specific duties and responsibilities as enshrined under the Regulations:

(a) Declaration of conflicts of interest: In case the surveyor is interested in the subject matter under loss assessment or in the policyholder whose subject matter is being assessed, he must declare the conflict to the insurer and stay away from the assessment exercise. For example, if the Surveyor is the son of the Policyholder whose car has been damaged in a fire accident, such a Surveyor cannot assess the loss of the car of his Father, in view of the conflict of interest. He must declare this relationship to the insurer concerned and not conduct the survey proceedings in such cases

(b) Maintenance of confidentiality and neutrality in the loss assessment exercise. He has to keep the interests of both the insurer and the policyholder in mind

(c) He must investigate the causes and circumstances of the loss in question

(d) He must personally conduct a spot survey and comment upon excess insurance or under insurance

(e) Advise the insurer about loss minimisation or loss control efforts or security and safety measures which can be adopted to ensure that the incidence of loss is reduced or avoided in future

(f) Pointing out discrepancy in policy wordings, if any

(g) Satisfying the queries of the insured or the insurer in connection with the claim or loss

(h) Recommending applicability of depreciation and its percentage and quantum

(i) Commenting on salvage and its disposal either the insurance company or the insured can appoint a licensed surveyor for any loss exceeding `20,000, within 72 hours of knowledge of loss to the insured. Notice of such appointment shall be sent to the insurance company or the insured, as the case may be. The Surveyor and Loss Assessor shall undertake survey only in the department for which license was In case there is any dispute or difference by the insured, another licensed surveyor shall be appointed to conduct the survey at the cost of the insured. Dispute on the quantum of loss may be referred to arbitration. A surveyor shall submit his report within 30 days of his appointment. In exceptional cases, the surveyor may seek extension of time up to 6 months from the insurer, under intimation to the insured. Where the report is incomplete, the insurer may seek additional report within 15 days of submission of the report by the Surveyor. Under such circumstances, the Surveyor shall submit the additional report within 3 weeks of request from the insurer.

THIRD PARTY ADMINISTRATORS-HEALTH

A Third Party Administrator ('TPA') is a person appointed by an insurance company to render services in connection with health insurance business or health cover, excluding the insurance business of an insurer and soliciting or procuring insurance business directly or through an intermediary or an insurance agent.

TPAs are normally engaged to provide services in connection with hospitalisation of an insured under a health insurance policy taken through a general insurance company or a standalone health insurance company or under health insurance rider covers offered by life insurance companies. They also offer certain other services like arranging for medical examination of the insured before a policy is issued by an insurance company etc. Requirements for becoming a

TPA A person can act as a TPA only with a valid licence issued by IRDA to perform the functions of a TPA.

The requirements for obtaining a licence are as follows:

(a) Entity: The person applying for a licence shall be an entity which is a Company under the Companies Act, 1956

(b) Primary object: The main object as per the Memorandum and Articles of Association shall be to carry on business in India as TPA in the health services. Further engaging in any business other than TPA is prohibited

(c) Minimum paid up capital: Rupees One crore and maintenance of working capital of Rs.1 crore at all times.

(d) One of the Directors to be registered with Medical Council: One of the directors of the TPA shall be a qualified medical doctor registered with Medical Council of India

(e) Foreign equity restricted to 26%: TPA entity shall not have foreign holdings in excess of 26%

(f) Transfer of shares in excess of 5%: Prior approval of IRDA necessary before affecting any transfer of shares in excess of 5% either through direct transfer or through issue of fresh equity shares to new or existing shareholders

(g) Fee: A processing fee of Rs.20,000 shall be payable along with the application. A further sum of `30,000 shall be payable as licence fee before the licence is issued

A licence granted under these Regulations shall be valid for 3 years, after which, upon payment of a renewal of `30,000, may be renewed for a further period of 3 years.

Intimation of certain changes to IRDA

Every TPA shall inform the appointment of a new Chief Executive Officer (‘CEO’) or Chief Administrative Officer (‘CAO’) or a Director on the Board of TPA to IRD within 30 days of appointment .

Every TPA shall inform IRDA the details of head office or branch offices closed or relocated within 15 days of such closure or relocation

Qualifications of CEO or CAO

Every person proposed to be appointed as a CEO or a CAO of the TPA shall possess the following qualifications:

(a) He shall hold a degree in arts, science, commerce or management or health or hospital administration or medicine

(b) A pass in the Associateship examination conducted by the Insurance Institute of India or such equivalent examination as decided by IRDA

(c) Completion of 100 hours of practical training with institutions recognized by IRDA

(d) He shall not be of unsound mind or undischarged insolvent or a person who had been subject to imprisonment for a period of 3 months by a Court on the grounds of misfeasance, misconduct or forgery etc. Decision making on claims by TPAs prohibited A TPA is prohibited from taking any decisions on any claims. A TPA can only assess and recommend admission of a claim or otherwise based on the guidelines provided by the insurer in terms of the agreement entered with them. Once the insurer takes a decision on the claim and communicates it to the TPA, the TPA shall clearly state as follows in their communication to the Policyholder who has registered a claim: "As per the instructions of the insurer the claim is being settled/denied for Rs. on account of . For any further clarifications, you may directly contact the insurer."

Bar on Non-insurance healthcare schemes

The TPA shall offer health services only in accordance with the IRDA (Third Party Administrators) Regulations, 2001 and shall not provide any services:

(a) directly or indirectly to non-insurance healthcare schemes or

(b) directly to health insurance schemes promoted, sponsored or approved by entities not

(c) being insurance companies, such as Governments, PSU's etc.

(d) directly or indirectly to the policyholder or insured, except the health services as per the agreement with the insurer.

Agreement between a TPA and an Insurance company

a. The insurer and the TPA shall themselves define the scope of the Agreement, the health and related services that may be provided by the TPA and the remuneration therefore. Provided that there shall be a clause in the Agreement for its termination by either party on grounds of mutual consent or any fraud, misrepresentation, inadequacy of service or other non-compliance or default fraud. Provided further that, there shall be no element in the Agreement which dilutes, restricts or otherwise modifies the stipulations of the IRDA in respect of Policy Holder welfare, protection, service standards and turnaround-time parameters.

b. The remuneration to the TPA shall be based on the services rendered to the insurer and shall not be related to the product/policy experience or the reduction of claim costs or loss ratios of the insurer.

c. A copy of the Agreement entered into between the TPA and the Insurance Company or any modification thereof, shall be filed, within 15 days of its execution or modification, as the case may be, with the Authority.

d. More than one TPA may be engaged by an insurance company and, similarly, a TPA can serve more than one insurance company

e. The Authority from time to time may prescribe minimum standard clauses to be included in the agreement between insurer and TPA.

Change of TPAs for servicing of Health Insurance Policies

a. A change in the TPA by the insurer shall be communicated to the policyholders 30 days before giving effect to the change.

b. The contact details like helpline numbers, addresses, etc. of the new TPA shall be made immediately available to all the policyholders in case of change of TPA.

c. The insurers shall take over all the data in respect of the policies serviced by the earlier TPA and make sure that the same is transferred seamlessly to the newly assigned TPA, if any. It shall be ensured that no inconvenience or hardship is caused to the policyholders as a result of the change.

In this regard, the following aspects shall receive special attention:

i. Status of cases where pre-authorization has already been issued by existing TPA.

ii. Status of cases where claim documents have been submitted to the existing TPA for processing.

iii. Status of claims where processing has been completed by the TPA and payment is pending with the insurer/ TPA.

Data and related issues

a. The TPA and the insurer shall establish a seamless flow of data transfer for all the claims.

b. The respective files shall be handed over to the insurer within 15 days of the claim settlement or rejection.

REGULATION OF INSURANCE BUSINESS IN INDIA

This millennium has seen insurance come a full circle in a journey extending to nearly 200 years. The process of re-opening of the sector had begun in the early 1990s and the last decade and more has seen it been opened up substantially. In 1993, the Government set up a committee under the chairmanship of RN Malhotra, former Governor of RBI, to propose recommendations for reforms in the insurance sector. The objective was to complement the reforms initiated in the financial sector. The committee submitted its report in 1994 wherein, among other things, it recommended that the private sector be permitted to enter the insurance industry. They stated that foreign companies be allowed to enter by floating Indian companies, preferably a joint venture with Indian partners. Following the recommendations of the Malhotra Committee report, in 1999, the Insurance Regulatory and Development Authority (IRDA) was constituted as an autonomous body to regulate and develop the insurance industry. The IRDA was incorporated as a statutory body in April, 2000. The key objectives of the IRDA include promotion of competition so as to enhance customer satisfaction through increased consumer choice and lower premiums, while ensuring the financial security of the insurance market. The IRDA opened up the market in August 2000 with the invitation for application for registrations. Foreign companies were allowed ownership of up to 26%. The Authority has the power to frame regulations under Section 114A of the Insurance Act, 1938 and has from 2000 onwards framed various regulations ranging from registration of companies for carrying on insurance business to protection of policyholders' interests. In December, 2000, the subsidiaries of the General Insurance Corporation of India were restructured as independent companies and at the same time GIC was converted into a national re-insurer. Parliament passed a bill de-linking the four subsidiaries from GIC in July, 2002. Today there are 24 general insurance companies including the ECGC and Agriculture Insurance Corporation of India and 23 life insurance companies operating in the country.

Beside IRDA Act and Insurance Act, 1938, there are some common Act/Regulation to the General and Life Insurance Business in India and some Acts have been made for specific requirement of Life Insurance/General Insurance Acts/Regulations common to General and Life Insurance Business in India The following Acts regulate the Insurance Business in India.

- Insurance Act, 1938
- IRDA Act, 1999
- Insurance Amendment Act, 2002
- Exchange Control Regulations (FEMA)
- Insurance Co-op Society
- Indian Stamp Act, 1899
- Consumer Protection Act, 1986
- Insurance Ombudsman

Regulations governing/ affecting Life Insurance Business in India

The following Acts govern /regulate the life insurance business in India.

- LIC Act, 1956
- Amendments to LIC Act

Regulations Affecting General Insurance Business in India

The following Acts affect, circumscribe or regulate in some way or the other, some aspect of the General Insurance Business in India.

• General Insurance Nationalization Act, 1972

• Amendments to GIN Act, 1972

• Multi-Modal Transportation Act, 1993

• Motor Vehicles Act. 1988

• Inland Steam Vessels Amendment Act, 1977

• Marine Insurance Act, 1963

• Carriage of Goods by Sea Act, 1925

• Merchant Shipping Act, 1958

• Bill of Lading Act, 1855

• Indian Ports (Major Ports) Act, 1963

• Indian Railways Act, 1989

• Carriers Act, 1865

• Indian Post Office Act, 1898

• Carriage by Air Act, 1972

• Workmens' Compensation Act, 1923

• ESI Act, 1948

• Public Liability Insurance Act. 1991

Why Regulation of Insurance Businesses is required?

Any industry wherein the stakes of the public are high would come within the purview of a Regulation – reason being that failure of such companies could result in serious implications on the economy of the country at large. Insurance business involves collection of money from various Policyholders, investing them properly, honouring the obligations of the Policyholders and providing an efficient service. It is important to ensure that the entities providing these services stick to their commitments. Failure to honour commitments by such entities could have major repercussions on the financial services industry. After liberalisation and entrance of Private players in Insurance business and Seeing the large numbers of customers and high risk potential, Government of India constituted the Insurance Regulatory and Development Authority in Year 1999.

CONSTITUTION OF INSURANCE REGULATORY AND DEVELOPMENT AUTHORITY

The IRD Act has established the Insurance Regulatory and Development Authority ("IRDA" or "Authority") as a statutory regulator to regulate and promote the insurance industry in India and to protect the interests of holders of insurance policies. The IRDA Act also carried out a series of amendments to the Act of1938 and conferred the powers of the Controller of Insurance on the IRDA. The members of the IRDA are appointed by the Central Government from amongst persons of ability, integrity and standing who have knowledge or experience in life insurance, general insurance, actuarial science, finance, economics, law, accountancy, administration etc. The Authority consists of a chairperson, not more than five whole-time members and not more than four part-time members. Every Chairperson and member of IRDA appointed shall hold office for a term of five years. However, Chairperson shall not hold office once he or she attains 65 years while whole time members shall not hold office beyond 62 years. Central Government may remove any member from office if he or she is adjudged insolvent or is physically or mentally incapacitated or has been convicted of an offence involving moral turpitude or has acquired financial or other interests or has abused his position. Chairperson and the whole time members shall not for a period of two years from the date of cessation of office in IRDA, hold office as an employee with Central Government or any State Government or with any company in the insurance sector.

POWERS /FUNCTIONS OF IRDA Under Section 14 of the IRDA Act, IRDA has the following powers:

(a) Issue of Certificate of Registration to insurance companies, renew, modify, withdraw, suspend or cancel the certificate of registration

(b) Protection of interests of policyholders in matters concerning assignment of policies, nomination, insurable interest, claim settlement, surrender value and other terms and conditions of insurance contract

(c) Specification of requisite qualifications, practical training and code of conduct for insurance agents and intermediaries

(d) Specification of code of conduct for surveyors and loss assessors

(e) Promoting efficiency in the conduct of insurance business

(f) Promoting and regulating professional organizations connected with insurance and reinsurance business

(g) Levying fees and other charges for carrying out the purposes of the Act

(h) Calling for information from or undertaking inspection of insurance companies, intermediaries and other oganisations connected with insurance business

(i) Control and regulation of rates, advantages, terms and conditions that may be offered by general insurance companies

(j) Specifying the form and manner in which books of account shall be maintained by insurance companies and intermediaries

(k) Regulation of investments of funds by insurance companies

(l) Regulation of maintenance of margin of solvency

(m) Adjudication of disputes between insurers and insurance intermediaries

(n) Supervising the functioning of Tariff Advisory Committee

(o) Specifying the percentage of premium income of the insurer to finance schemes for promoting and regulating professional organizations

(p) Specifying the percentage of insurance business to be undertaken by insurers in rural or social sectors

(q) Such other powers as may be prescribed.

Powers of IRDA with reference to control of management of insurance companies, takeover of management, mergers, acquisitions and winding up Section 52A empowers IRDA to make a report to Central Government if the affairs of a Life insurance Company are carried on in any manner prejudicial to the interests of policyholders.

Based on the Report, the Central Government is empowered to appoint an Administrator to manage the affairs of the life insurance company.

A report shall be filed by such Administrator to the Central Government giving his recommendations on the way forward, including the options of transfer of business to an existing insurer or winding up, as he deems fit.

Central Government is empowered to take such action as it deems fit based on the Report of the Administrator.

Section 52H empowers Central Government to acquire the undertaking of any insurer based on a report from IRDA on failure to comply with directions or if the insurance company is being managed in a manner detrimental to the public interest or in the interests of public or policyholders it is appropriate to do so.

Central Government may make a scheme for transfer of undertaking of the insurer to another insurer in such cases and decide the appropriate compensation in such cases.

The Central Government may constitute a Tribunal comprising of a Chairman (a person who is or has been a Judge of the Supreme Court or a High Court) and two other members (one of whom has experience in insurance and the other a Chartered Accountant) for this purpose.

Section 53 empowers the Tribunal to order for winding up in accordance with the Companies Act, 1956, if based on a petition presented by shareholders holding not less than one-tenth of the whole body of shareholders and holding not less than one-tenth of the whole share capital or by not less than fifty policyholders holding life insurance policies in force for not less than three years of total value of not less than `50,000, the Tribunal is satisfied to do so. In addition, IRDA may also apply to the Tribunal for winding up on the following grounds:

(a) That the insurance company failed to deposit or keep deposited with Reserve Bank of India, the amount required to be deposited under Section 7 or Section 98

(b) That the insurance company has failed to comply with any requirement of the Insurance Act or has continued contravention for a period of three months after notice of such failure or contravention has been conveyed to the Company by IRDA

(c) That it appears from returns or statements filed by the Company or from the results of the Company that the company is deemed to be insolvent

(d) That the continuance of the company is prejudicial to the interests of the policyholders or to the public interest generally

It may be noted that Section 54 of the Act prohibits voluntary winding up of insurance companies, except for the purpose of effecting an amalgamation or reconstruction of the company or on the ground that by reason of its liabilities it cannot continue its business. This provision overrides the provisions of the Companies Act, 1956 on this point. An appeal against the Tribunal formed under the Insurance Act shall lie with the National Company Law Appellate Tribunal

Opening of places of business requires prior approval of IRDA Section 64VC requires every insurance company to take a approval in advance in IRDA for opening any place of business or for relocation of an existing place of business outside the same city, town or village. The approval is required to be sought for opening of any offices, whether called as Branch office, Head Office, Administrative office, Satellite office or any other similar names.

Powers of IRDA for imposition of penalties for default in complying with the Act (Section 102) Section 102 empowers IRDA to impose a penalty not exceeding Rupees five lakhs for each of the following failures by an insurance company:

(a) Failure to furnish any document, statement, account, return or report to IRDA

(b) Failure to comply with the directions (Section 34 empowers IRDA to issue directions if it is satisfied to do so in the interests of public or for prevention of affairs being conducted detrimental to policyholders or to secure proper management of any insurer)

(c) Failure to maintain the required solvency margin

(d) Failure to comply with the directions on the insurance treaties Further Section 105B empowers IRDA to impose a penalty not exceeding Rupees Five lakhs for failure to comply with Section 32B, while Section 105C empowers IRDA to impose a penalty not exceeding Rupees Twenty five lakhs for failure to comply with Section 32C, with cancellation of certificate of registration for continuing failure.

Regulation/Guidelines relating to Licensing Audit and Supervisions of Insurance Companies Insurance Regulatory and Development Authority (Registration of Indian Insurance Companies) Regulations, 2000, contains the provisions relating to licensing of Insurance companies in India. These provisions have been amended from time to time and provide detailed guidelines for registration as Insurance Company in

India. For supervising the operations of Insurance Companies in India, IRDA has issued various guidelines from time to time and discussed under relevant chapters. As per the Insurance Regulatory and Development Authority (Registration of Indian Insurance Companies) Regulations, 2000 (as amended), every entity wishes to work as an Insurance Company needs to apply with IRDA in the prescribed format.

IRDA (Licensing of Insurance Agents) Regulations, 2000 & IRDA (Licensing of Corporate Agents), 2002

These Regulations provide for the conditions of licensing for individual insurance agents under Section 42. The Regulations cover the following:

(a) Prescription of application for IRDA licensing along with the fees required

(b) Prescription of minimum qualifications for becoming an insurance agent – 12th standard or equivalent examination if the Agent resides at places with population of 5,000 or more as per census and a pass in the 10th standard or equivalent examination for candidates residing in any other place

(c) Practical training requirements from an approved training institution for 50 hours covering various insurance subjects. Further, the training hours for an agent who is going for a composite licence – i.e. one life and one non-life licence, the training requirement is 75 hours Where the applicant possesses professional qualifications such as membership of the Institute of Chartered Accountants, Cost an Works Accountant or Company Secretaries, Actuaries or an MBA, the number of training hours is reduced to 25.

(d) Pre-recruitment examinations to be conducted by the Insurance Institute of India

(e) Prescription of codes of conduct for Agents In the case of Corporate Agents, i.e. where the entity licensed as an agent is a Company or firm, it must have at the minimum a Corporate Insurance Executive and Specified Persons who are employees of the Corporate Agent entity and who will have to possess minimum qualifications, undergo the practical training and pass the examination conducted by the Insurance Institute of India. A licence issued under these Regulations is valid for a period of 3 years after which it shall be renewed for continued eligibility for Agents to solicit or procure insurance business. Insurance Surveyors and Loss Assessors (Licensing, Professional Requirements and Code of Conduct) Regulations, 2000, Insurance Surveyors and Loss Assessors (Licensing, Professional Requirements and Code of Conduct) Regulations, 2000, as amended by, Insurance Surveyors and Loss Assessors (Licensing, Professional Requirements and Code of Conduct) (Amendment) Regulations, 2013 contains provisions relating to registration, regulation and supervision of Insurance and loss surveyors in India. Insurance Regulatory and Development Authority (Health Insurance) Regulations, 2013 Insurance Regulatory and Development Authority (Health Insurance) Regulations, 2013 contains the provisions relating to registration and other requirement relating to third party administrator in India.

IRDA (SCHEME OF AMALGAMATION AND TRANSFER OF LIFE INSURANCE BUSINESS) REGULATIONS, 2013 AND IRDA (SCHEME OF AMALGAMATION AND TRANSFER OF GENERAL INSURANCE BUSINESS REGULATIONS, 2011)

Under the provisions of the Act, a Scheme of amalgamation or transfer is possible only between two life insurance companies or two general insurance companies, It is not possible for a life insurance company to be acquired by a general insurance company or vice versa, since separate insurance companies are required to be formed for transacting life and general insurance businesses.

The Regulations require submission of every proposal for implementation of proposed amalgamation to be submitted to IRDA for a prior approval along with the draft Scheme of amalgamation. However, before submission of the application, notice of intention to submit the application shall be submitted one month before filing the application for approval for every proposal for implementation as above along with a statement on the nature of amalgamation or transfer along with the following documents:

(a) Draft of the agreement for the proposed amalgamation or transfer

(b) Balance Sheets of both the target insurance company and the acquiring insurance company
(c) Financial Condition Report. Solvency Statements and Incurred but not Reported (IBNR) Report of both the insurance companies

(d) Report by an Independent Actuary (who has not been connected with any of the two insurance companies during the past 3 years) on the proposed amalgamation or transfer

(e) Executive summary of the proposed amalgamation or transfer along with the terms on which the transaction has been contemplated

(f) Report on the manner in which the interests of Policyholders will be protected and the compliance with the applicable laws including the Competition Act, 2002 The financial statements shall be prepared as on the appointed date, i.e. date fixed for the purpose of giving effect to the scheme of amalgamation or transfer and IRDA may cause an independent actuarial valuation of the insurance businesses of the transacting parties. IRDA would then consider issue of an in-principle approval for the proposed amalgamation or transfer.

Upon receipt of the in-principle approval, the transacting parties shall inform their respective Policyholders about the proposed Scheme of amalgamation or transfer as follows:

(a) Keeping the Scheme open for inspection for Policyholders at the Head office;

(b) Uploading the Scheme in the website of the transacting parties;

(c) Statement on nature and terms of amalgamation to be published in one leading National and one vernacular Newspaper and filing copies with IRDA;

(d) Informing all the Policyholders individually giving notice about the application for the proposed amalgamation or transfer. Upon receipt of the in-principle approval from IRDA, the transacting parties would seek other legal clearances or regulatory approvals, including the following: (a) Filing of the Scheme of arrangement, along with the in-principle approval of IRDA, before the relevant Court or Tribunal for confirmation of the Scheme of arrangement under Sections 391 to 394 of the Companies Act, 1956; (b) Filing applications before the Foreign Investments Promotion Board or Reserve Bank of India for seeking necessary approvals; (c) If the insurance companies have a foreign insurance company as a promoter who is regulated in their country of origin, necessary regulatory approvals for the proposed Scheme from the concerned regulator. (d) Such other approvals, including the approval of Securities and Exchange Board of India or the Competition Commission of India.

Upon receipt of all the legal clearances or other regulatory approvals, the transacting parties shall submit all the other approvals to IRDA for seeking their final approval. A final approval is then considered by IRDA keeping in mind the stipulations laid down by the Court/Tribunal and other regulatory authorities and the following considerations:

(a) compliance with the solvency margin requirements after the proposed transfer

(b) compliance with other applicable laws

(c) protection of interests of Policyholders

(d) orderly growth of the insurance industry and shall accordingly grant the final approval.

Upon receipt of final approval from IRDA, the following are the consequences:

(a) The scheme of amalgamation and transfer shall take effect from such date as may be specified by IRDA while granting the final approval;

b) The final approval shall be binding on all Policyholders, Creditors or employees of both the transacting parties;

(c) The assets and liabilities of the transferor insurer shall vest with the transferee insurer from the effective date of transfer;

(d) Publication in one national and one vernacular newspaper confirming completion of the process of amalgamation or transfer. In respect of amalgamation or transfer completed between two life insurance companies, the transferee insurer shall file a certified true copy of the scheme, deed or agreement under which the amalgamation or transfer has been effected along with a declaration from the Chairman and the Principal Officer listing down the various payments made or to be made to any person on account of the amalgamation or transfer effected

IRDA GUIDELINES FOR GRIEVANCE REDRESSAL In order to enforce timely redressal of Customer grievance, the Insurance Regulatory and Development Authority (IRDA) has issued guidelines for grievance redressal by insurance companies. A Grievance is defined as an expression of dissatisfaction by a customer on the action or inaction on the standard of service or deficiency of service of an insurance company or any intermediary and asks for remedial action. It is distinguished from inquiry or a request which is seeking information or requesting for a service and are not considered as Grievances. Every insurance company shall have a designated senior officer at the level of CEO or Compliance Officer of the Company as the Grievance Officer. Further every office of the insurer shall also have a designated Grievance officer for such office.

The process for handing a Grievance is as follows:

(a) Every grievance shall be acknowledged within 3 working days of receipt of grievance, containing the name and designation of the person who will deal with the grievance

(b) The Grievance redressal procedure including the time taken for resolution of disputes shall be mentioned in the acknowledgement

(c) Normally a Grievance shall be resolved within 3 days. However, where it is not possible to resolve within 3 days, the insurer shall resolve the complaint within 2 weeks and shall send a final letter of resolution

(d) Where a complaint is rejected, the reasons shall be clearly stated alongwith the recourse available if the customer is still dissatisfied

(e) Further if the insurer shall inform the customer that if the customer does not come back within 8 weeks from the date of providing resolution, the grievance shall be treated as closed

(f) A grievance can be closed only if the following conditions are satisfied:

1. Where the insurance company has acceded to customer's grievance, upon acceding to the request of the customer

2. Where the insurance company rejects the customer's grievance, upon receipt of a communication from customer accepting the company's resolution

3. Where the insurance company rejects the customer's grievance and the customer does not respond within 8 weeks of receipt of resolution, upon completion of the 8 weeks

4. In all the above instances, the Grievance Redressal Officer shall certify that the Insurance company has discharged its contractual, statutory or regulatory obligations Every insurance company shall publish the Grievance Redressal Procedure in the website of the insurance company. The Policyholders Protection Committee of the Insurance Company shall receive reports concerning Grievances and shall monitor the process of handling grievances.

IRDA (Obligations of Insurers to Rural and Social Sectors) Regulations, 2000 (as amended from time to time) IRDA (Obligations of Insurers to Rural and Social Sectors) Regulations, 2000 provides that every insurance company is required to undertake a minimum percentage of business providing insurance coverage to persons residing in rural areas and providing coverage to persons who are engaged in social sector. Rural areas have been defined as those places which have been classified as rural areas as per the latest census. The obligations of insurers under Rural Sector is calculated as a percentage of the total number of policies sold by an insurance company and is dependent on the age of the insurance company as follows: For a life insurance company, the percentage with 7% (2%) in the first financial year of operations, increases to 12% (5%) in third financial year and 16%(5%) in the fifth financial year and 20% (7%) in the tenth financial year. Note: figures in brackets indicate obligations of general insurance companies. In respect of Social sector, the obligation is in terms of number of Lives assured covered under an Insurance policy belonging to social sector occupations as defined in the Regulations. The number of lives required to be covered under this sector is also dependent on the age of the insurance company as follows: For both Life and General insurance companies, the number of lives to be covered increases from 5,000 lives in the first financial year to 20,000 lives in the fifth financial year and 55,000 lives in the tenth financial year Social Sector is defined unorganised sector, informal sector, economically vulnerable or backward classes and other categories of persons, both in rural and urban areas.

IRDA (Micro Insurance) Regulations, 2005 A micro insurance products is designed to meet the needs of persons, especially residing in rural areas, 82 PP-IL&P whose primary requirement is basic insurance coverages in life, such as payment of insurance benefit upon death of the bread winner, to the family or Health insurance etc. The intention is provide a low cost product to such persons. A life micro insurance product is therefore a pure term insurance product, or an endowment assurance product or a health insurance product with or without accident benefit. A general micro insurance product includes health insurance, insurance coverage on huts, livestock, tools or instruments or any personal accident contract. Minimum and maximum amount of sum assured have been prescribed for each product category under Schedule I and Schedule II to the Regulations. For any of the product categories the sum assured cannot be less than `5,000 or more than `50,000. A Non Governmental Organisation or a Self Help Group or a Micro Finance Institution or a Non-profit organisation (Companies registered under Section 25 of the Companies Act, 1956) can be appointed by an insurer to act as a Micro Insurance Agent. The Regulations provide for a tie up between a Life insurance company and a General insurance company for offering both life and general micro insurance products together to a customer. A micro insurance product may be distributed by a licensed agent or an insurance broker, but a Micro insurance agent is prohibited from distributing any insurance product other than micro insurance products. A micro insurance agent is allowed to act as an agent for micro insurance products of one life insurance company and one general insurance company at a time by entering into an agreement with them. The insurers concerned shall impart 25 hours training on micro insurance products, customer service, claims etc. to the Micro insurance agents. A micro insurance agent shall appoint Specified persons who are authorised to sell on behalf of the Micro insurance agent (who can be a NGO or SHG or MFI as above) All insurance companies are expected to issue polices in vernacular language to facilitate customer understanding of the policy terms and conditions. Where it is not possible a write up in vernacular language must be attached with the policy document. A micro insurance agent may be paid a remuneration not exceeding 10% for single premiums received, 20% (15% for general insurance companies) for the premiums received during all policy years. All micro insurance products sold shall be reckoned for the purpose of social sector obligations of an insurance company. Where the micro insurance product is also sold in a rural area, it shall be counted both for rural and social sector obligations separately. Exposure draft to Micro Insurance (Modification) Regulations On comprehensively examining the existing business model adopted under Micro Insurance vis-a-vis the extant regulations on Micro Insurance,

IRDA proposed to review the IRDA (Micro Insurance) Regulations, 2005. Accordingly, an exposure draft on Micro Insurance (Modification) Regulations was issued in July, 2012 for further and wider deliberations on the subject. As on August, 2013, the modified rules are yet to be published by IRDA. IRDA GUIDELINES TO FINANCIAL INCLUSION Insurance Regulatory & Development Authority (IRDA) has been making immense efforts to educate and Lesson 4 Regulatory Environment – Specific Legislations 83 empowers the common citizens about insurance industry in India and their rights & responsibilities. IRDA has been at the forefront of insurance sector deepening, protecting the rights of policyholders, regulating insurance companies & advisors and bringing about insurance inclusion in India for all segments esp. the poor.

Some of the steps taken by **IRDA for financial inclusion include**

1. National Strategy for Financial Education the Insurance Regulatory and Development Authority (IRDA) has released the draft National Strategy for Financial Education for comments and feedback in Year 2012. The final strategy is yet to be notified by the IRDA. The National Strategy recognises that financial literacy and financial education play a vital role in financial inclusion and inclusive growth and envisages ways towards creating awareness and educating consumers on access to financial services, availability of various types of products and their features; changing attitudes to translate knowledge into responsible financial behaviour; and making consumers of financial services understand their rights and obligations. The National Strategy seeks to create a financially aware and empowered India. It aims at undertaking a massive Financial Education campaign to help people manage money more effectively to achieve financial well being by accessing appropriate financial products and services through regulated entities with fair and transparent machinery for consumer protection and grievance redressal.

2. Website on Insurance Education In an attempt to increase insurance awareness levels across the country, the authority has taken a number of consumer education initiatives and has recently launched an exclusive insurance education website www.policyholder.gov.in This website has self-explanatory menus and gives information in simple language on topics such as: • Buying insurance

• Making a claim

• Policyholder Protection and Grievance Redressal

• Handbooks in 13 languages

• Do's and Don'ts for a policyholder

• Comic series • Consumer Affairs Annual Booklets

3. Grant of Corporate Agency license to Department of Postal To promote financial inclusion, insurance regulator Insurance Regulatory and Development Authority (IRDA) has granted corporate agency license to the Department of Post for distributing insurance products.

4. Emphasis on educating insurance agents to weed out mis-selling India's Insurance Regulatory and Development Authority (IRDA) has been chalking out an ambitious plan to combat mis-selling, a menace that has been haunting the industry for about a decade now, especially after the emergence of equity-oriented insurance products. During fiscal year 2012, the regulator received 1 lakh complaints on mis-selling. IRDA has been emphasizing specialized training to the country's 2.5 million insurance agents after they clear the basic examination to qualify as a licensed agent to sell insurance products. The training, aimed at instilling seriousness among insurance agents about sales as a career and stop unfairly selling insurance schemes just to earn commissions.

IRDA REGULATION RELATING TO PRODUCTS APPROVAL An insurance company cannot launch any product unless the product specifications are filed with IRDA and are approved by them. This procedure is popularly called "file and use" procedure under the IRDA Regulations. This procedure is required to be followed whenever a new product is launched or whenever an existing product is withdrawn or modified. IRDA have recently issued the following two Regulations, subsuming all the existing notifications with reference to Product design:

(a) IRDA (Non-Linked Insurance Products) Regulations, 2013

(b) IRDA (Linked Insurance Products) Regulations, 2013 A linked life insurance product is one which combines the benefit of insurance coverage and investment in one product. Under this type of product, the balance amount available after appropriation of charges, including the mortality charges, in invested in market linked investments. For example, investment in listed equities or bonds. The Policyholder, in addition to providing the fundamental risk coverage, a linked insurance product also provides an investment management service and the value of investment is reflected in the form of Net asset value from time to time. The risk on the investment portion lies with the Policyholders. A non-linked life insurance product, on the other hand, does not provide the investment management service on behalf of the policyholders. Typically, the following are the benefits under a non-linked insurance product:

(a) Covers risk of mortality – i.e. risk of dying early – provides sum assured on death, e.g. Term insurance policies or whole life insurance policies which provide sum assured only on death

(b) sum assured which can be provided on survival to the maturity of the policy, e.g. Endowment Policies which provide for sum assured on death or on maturity whichever is earlier

(c) Annuity contracts, which covers the risk of living longer, by providing periodic payments as long as the policyholder is alive

(d) Health insurance contracts, which cover the risk of hospitalization (General insurance companies also offer health insurance contracts on indemnity basis)

(e) Rider benefits e.g. Accident Death Benefit rider (where an additional sum assured is paid on death due to accident)