Lecture Notes

INTRODUCTION TO BANKING BUSINESS

MBA III SEMESTER

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UNIT- I
INTRODUCTION TO BANKING BUSINESS

1.1 Introduction to banking sectors:

Introduction

H. L. Henry defined a banker as “One who in the ordinary course of business honours cheques drawn upon by persons from and for whom he receives money on current account”. This definition is very restrictive in the sense that any person or institution engaged in the business of attracting deposits may be called as bank.

Kinley’s Definition: A bank is an “establishment which makes to individuals such advance of money as may be required and safely made and to which individuals entrust money when not required by them for use”.

The definition of R. S. Sayers, however, reveals the true character of a modern bank. In his words, “Banks are institutions whose debts usually referred to as bank deposits are commonly accepted in final settlement of other people’s debts”.

Under British Law “A banker is one who in the ordinary course of his business, honours cheques drawn upon him by persons from and for whom he receives money on current accounts”. (Dr.Herbert L. Hart)

Under Indian Law Banking Regulation Act of India, 1949 “Accepting, for the purpose of lending or investment, of deposits of money from the public, repayable on demand or otherwise and withdrawal by cheque, draft, and order or otherwise” (Section 5b).

1.1 Nature and Origin of the Word ‘Bank’

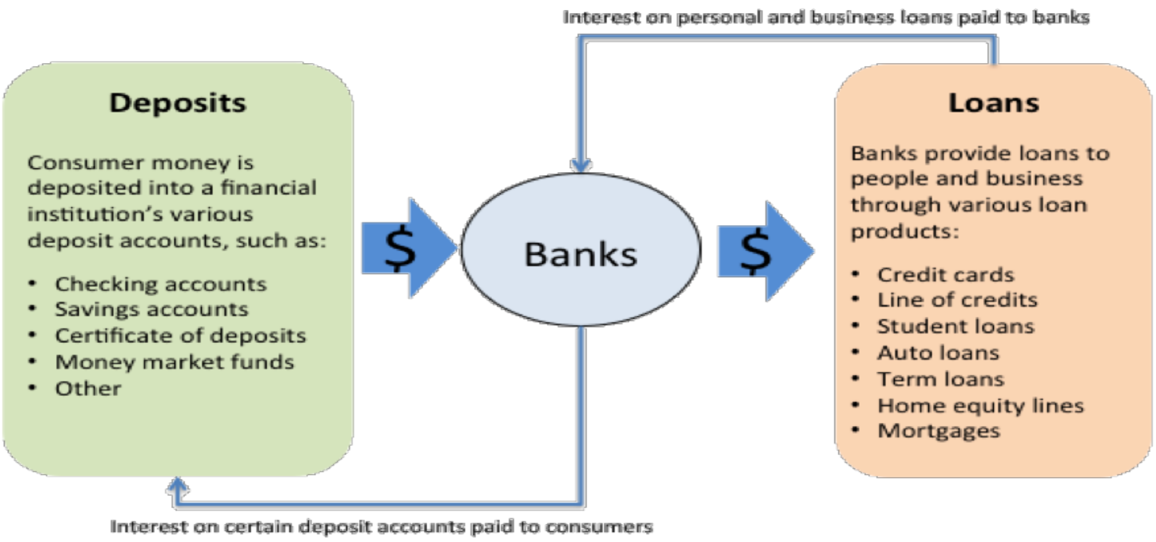
The name bank is derived from the Italian word banco “desk/bench”, used during the Renaissance by Florentine bankers. These bankers used to make their transactions above a desk covered by a green tablecloth.

There are traces of banking activity even in ancient times. In fact, the word traces its origins back to the ancient Roman Empire, where moneylenders would set up their stalls in the middle of enclosed courtyards called macella on a long bench called a bancuit. It is from here that the words banco and bank are derived. As a moneychanger, the merchant at the banco did not invest much money but merely converted the foreign currency into the only legal tender in Rome that was the Imperial Mint.

In simple terms, a bank is an institution that accepts various types of deposits and then advances money in form of loans to people requiring it. Money and credit provide the pivot (axle) around which all the economic activities revolve.

Banks are institutions, which accept deposits and use these funds to grant loans. Banks collect the surplus funds of millions of individual savers who are widely scattered. The money so collected is channelized to the investors i.e. people asking for loans for further investment purposes. Banks help in money growth and capital formation. They are reservoirs of resources for economic growth and development of the nation. They help in building the infrastructure; boosting the agriculture, setting up industries and aid to global trade. Thus, a bank by discharging its functions effectively enhances productive and industrial capacity of the nation and boosts its pace of growth.

Structure of Indian banking system



Scheduled Banks: A scheduled bank, in India, refers to a bank which is listed in the 2nd Schedule of the Reserve Bank of India Act, 1934. Banks not under this Schedule are called non-scheduled banks. Scheduled banks are usually private, foreign and nationalised banks operating in India. However, cooperative banks are allowed to seek scheduled bank status if they satisfy certain criteria. A scheduled bank is eligible for loans from the Reserve Bank of India at bank rate. They are also given membership to clearing houses.

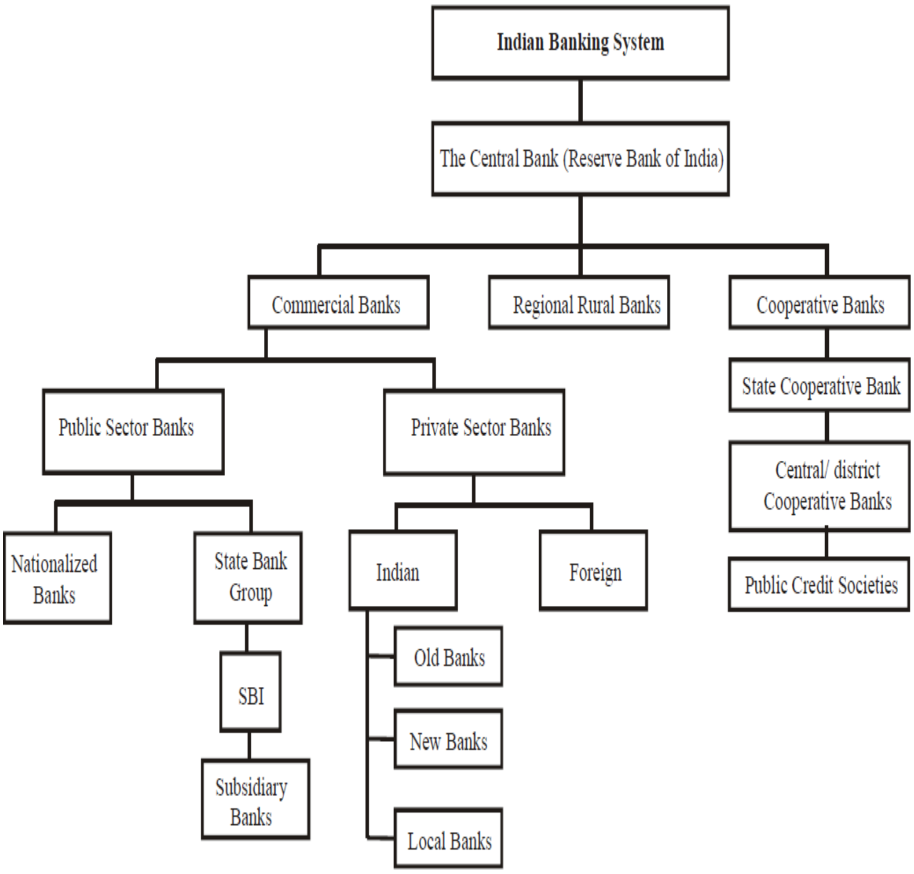
Non Schedules Banks:

1. Other than the schedule banks the banks that formally obtains the licence from the banks

2. All most all the existing banks in India are scheduled and the number of non-scheduled banks is almost nil. Only a countable number of few banking sectors have claimed exemption from the Second Schedule of banking Regulation Act. In the year 2006, only a total of three non-scheduled banks existed in India. By 2011 and counting, the number of non-scheduled banks in our country increased by one. Till today India has only four non-scheduled banks in existence. These four Non-scheduled banks under operation in India are :

    1. Akhand Anand Cooperative Bank Limited
    2. Alavi CoOperative Bank Limited
    3. Amarnath CoOperative Bank Limited
    4. Amod Nagrik Sahakari Bank Limited

Scheduled Banks structure



COMMERCIAL BANKS:

Commercial Banks are the institutions, setup as per the provisions of the Banking Regulation Act, 1949.

These institutions ordinarily accept deposits from the people and advances loans. They also create credit. Scheduled banks and non-scheduled banks come in the category of Commercial Banks.

SCHEDULED AND NONSCHEDULED BANKS:

SCHEDULED BANKS:

- Scheduled banks are listed in the second schedule of the RBI and their minimum paid-up capital and reserve fund amounts to 25 lakh.
- Every week these banks have to submit details of their activities to the RBI.

NONSCHEDULED BANK

- Paid-up capital of such bank is less than Rs 5 lakh, they are not listed in the second schedule of the RBI and RBI doesn't have any functioning control over them.
- Every week these banks have to submit details of their activities to the RBI.

STRUCTURE OF SCHEDULED BANKS IN INDIA PUBLIC SECTOR BANKS:

Managed, Controlled and Owned by the government. Public Sector Banks are divided into four groups:

1. State Bank Group
2. Nationalized Banks
3. Regional Rural Banks
4. Other Public Sector Banks

1. STATE BANK GROUP:

- It consists of State Bank of India (SBI) and its seven associate banks. SBI (Estd: 1955) is the first public sector bank of the country.
- State Bank of India (Subsidiary) Act was passed in 1959. As per the provisions of this Act, seven banks of the erstwhile princely states were made the subsidiary banks of SBI. They were:
  1) State Bank of Hyderabad
  2) State Bank of Jaipur and Bikaner
  3) State Bank of Mysore **Merged with SBI on 1st April 2017**
  4) State Bank of Patiala
  5) State Bank of Travancore
  6) Bhartiya Mahila Bank
  7) State Bank of Indore (merged with SBI on 26 Aug 2010)
  8) State Bank of Saurashtra (merged with SBI on 13 Aug 2008)

Note: Present SBI is the largest commercial bank of India and its five subsidiary banks were also merged with SBI on 1st April 2017. RBI owns the majority shares of SBI and some of its associate banks.

2. NATIONALIZED BANK (19):

In order to increase the branch network, the Government of India has done the nationalization of 14 scheduled commercial banks in 1969 and 06 more in 1980. These 20 nationalized banks became 19 when **New Bank of India was merged into Punjab National Bank**. List of 19 nationalized banks is appended below:

1) Andhra Bank
2) Bank of Baroda
3) Central Bank of India
4) Allahabad Bank
5) Canara Bank
6) Indian Bank
7) Bank of Maharashtra
8) Indian Overseas Bank
9) United Bank of India
10) Corporation Bank
11) Bank of India
12) Punjab & Sind Bank
13) Vijaya Bank
14) Dena Bank
15) Oriental Bank of Commerce
16) Syndicate Bank

17) Punjab National Bank
18) UCO Bank
19) Union Bank of India

3. REGIONAL RURAL BANKS (RRBS) :

- RRBs fill the credit gaps left by the cooperative banks and public sector banks in the rural credit demand.
- Five Regional Rural Banks were established on 02 October 1975, on the recommendation of the Banking Commission (1972).
- Their Main function was to provide financial help to small and marginal farmers and rural workers in order to develop rural economy. RRB's are owned by Central government, State Government and the sponsor/founder banks in the ratio 50:15:35 and are regulated by National Agriculture and Rural Development Bank (NABARD).
- RRBs are started for regional inequalities. Concept for RRBs is "BRD" Balanced regional development
- Ariel awareness for RRBs report given by D.R,Gadgil : 1962
- Lead Bank Scheme Proposed by M.Narasimhan Committee : 1969
- First Recommitted setup for RRBs is Sarayu Committee : 1972
- Committee recommended setting up RRBs is Narasimhan Committee in : 1975
- First RRB set up was Prathama Grameen bank on 2nd October 1975 in which sponsored by
- Syndicate Bank Under RRB Act 1976 when Indira Gandhi was the Prime Minister
- Ownership ratio of stakeholders in the RRBs : Central government 50%, State government15%,and sponsored bank 35%
- RRBs regulates by NABARD (National Bank for Agricultural and Rural Development)
- Total Number of RRBs as of now—56 (In 2006—133 RRBs, 2011—82, 201364)
- **Indian States that do not have any RRBs : Goa and Sikkim**
- At present only 7 states have state level RRBs
- The Regional Rural Banks (Amendment bill 2014) increased authorised capital from Rs 5 crore to Rs 2000 crore
- First Fully computerised RRB in the country is : South Malabar Grameen bank , Malappuram, Kozhikode, Kerala.
- Minimum Capital To Risk weighed Assets ratio (CRAR) of RRBs which they have to maintain is 9%
- Agricultural review committee as per RRBs loans Khushro Committe1989
- Committee for Recapitalisation of RRBs : KC Chakrabarthy 2010
- Committee to offer higher salary and perquisites to attract competent officers : K.Mitra Committee

4. OTHER PUBLIC SECTOR BANKS:

Bhartiya Mahila Bank and IDBI Bank are the two scheduled commercial banks which comes in the category of "other Public Sector Banks".

Note: Bhartiya Mahila Bank is merged with SBI on 1st April 2017.

PRIVATE SECTOR BANKS: (13+9): Ownership vests in the private sector. They fall under three categories.

Banks Regulates by RBI

RRB's regulates by NABARD

Old Private Banks (13)

1) Karur Vysya Bank
2) Dhanlaxmi Bank
3) Federal Bank
4) Nainital Bank
5) ING Vysya
6) Ratnakar Bank
7) Jammu and Kashmir Bank
8) Catholic Syrian Bank
9) Karnataka Bank
10) City Union Bank
11) Lakshmi Vilas Bank
12) Tamilnad Mercantile Bank
13) South Indian Bank

New Private Banks (09): New private banks provide high level of modern customer services.

1) Yes Bank
2) Kotak Mahindra Bank
3) ICICI Bank
4) HDFC Bank
5) Development Credit Bank
6) IndusInd Bank
7) Axis Bank
8) Bandhan Bank (2015)
9) IDFC (Industrial Development Financial Corporation)

FOREIGN BANKS (46)

Foreign banks are those banks whose headquarters are situated in foreign countries. Earlier these banks used to restrict their activities primarily to foreign exchange and so they were called Foreign Exchange Banks. But now they are performing all sorts of banking functions and are now called as Foreign Banks.

PAYMENT BANKS

Payments banks are a new model of banks conceptualised by the Reserve Bank of India (RBI).

These banks can accept a restricted deposit, which is currently limited to 1 lakh per customer and may be increased further. These banks cannot issue loans and credit cards. Both current account and savings accounts can be operated by such banks. Payments banks can issue services like ATM cards, debit cards, net banking and mobile banking.

Airtel has launched India's first live payments bank. Paytm is the second such service to be launched in the country. India Post Payments Bank is the third entity to receive payments bank permit after Bharti Airtel and Paytm.RBI Guidelines

Regulations

- The minimum capital requirement is 100 crore.
- For the first five years, the stake of the promoter should remain at least 40%.
- Foreign share holding will be allowed in these banks as per the rules for FDI in private banks in India.
- The voting rights will be regulated by the Banking Regulation Act, 1949. The voting right of any shareholder is capped at 10%, which can be raised to 26% by Reserve Bank of India.
- Any acquisition of more than 5% will require approval of the RBI.
- The majority of the bank's board of directors should consist of independent directors, appointed according to RBI guidelines.
- The bank should be fully networked from the beginning.
- The bank can accept utility bills.
- It cannot form subsidiaries to undertake nonbanking activities. Initially, the deposits will be capped at 100,000 per customer, but it may be raised by the RBI based on the performance of the bank.
- The bank cannot undertake lending activities. 25% of its branches must be in the unbanked rural area. The bank must use the term "payments bank" in its to differentiate it from other types of bank.
- The banks will be licensed as payments banks under Section 22 of the Banking Regulation Act, 1949, and will be registered as public limited company under the Companies Act, 20103.

Eligibility criteria:

- Existing nonbank Prepaid Payment Instrument (PPI) issuers, mobile firms and supermarket chains, among others existing NBFCs and micro finance lenders are promoters who are eligible to set up payment banks.
- Large public sector enterprises and big industrial houses are not allowed to establish Payment banks.
- A promoter or promoter group can have a joint venture with an existing scheduled commercial bank to set up a payments bank. But they should have a sound track record of five years period of running businesses.
- Payment Banks will initially be restricted to holding a maximum balance of 1 lakh rupees per individual customer. It can issue ATM or debit cards but not credit cards.
- Payment bank cannot undertake lending activities but can distribute the non- risk sharing simple financial products such as mutual fund units and insurance products, etc.
- These banks also should maintain Cash Reserve Ratio (CRR) with the Reserve Bank; it will be required to invest minimum 75 percent of its demand deposit balances in Statutory Liquidity Ratio
- (SLR) with maturity up to one year and hold maximum 25 per cent in current and time or fixed deposits with other scheduled commercial banks for operational purposes and liquidity management.

- The minimum capital for payments banks is 100 crore rupees and it should have a leverage ratio of not less than 3 percent that is its outside liabilities should not exceed 33.33 times its net worth (paid-up capital and reserves).
- The promoter’s minimum initial contribution to the paid-up equity capital for payments bank shall at least be 40 percent for the first five years from the commencement of its business.
- The foreign shareholding in the payments bank should be as per the Foreign Direct Investment (FDI) policy for private sector banks as amended from time to time.
- The operations of the bank should be fully networked and technology driven from the beginning, conforming to generally accepted standards and norms. It should have a high powered Customer Grievances Cell to handle customer complaints
- Those who are interested can apply before January 16 for first round of such permits however these guidelines are subjected to periodic review and revision.
- External Advisory Committee (EAC) of RBI will evaluate the applications and decision to issue an in principle approval for setting up of payment bank will be taken by RBI.
- The validity of the in principle approval issued by the Reserve Bank will be eighteen months.

History

- On 23 September 2013, Committee on Comprehensive Financial Services for Small Businesses and Low Income Households, headed by Nachiket Mor, was formed by the RBI.
- On 7 January 2014, the Nachiket Mor committee submitted its final report.
- Among its various recommendations, it recommended the formation of a new category of bank called payments bank.
- On 17 July 2014, the RBI released the draft guidelines for payment banks, seeking comments for interested entities and the general public.
- On 27 November, RBI released the final guidelines for payment banks.
- In February 2015, RBI released the list of entities which had applied for a payments bank licence. There were 41 applicants.
- It was also announced that an external advisory committee (EAC) headed by Nachiket Mor would evaluate the licence applications.
- On 28 February 2015, during the presentation of the Budget it was announced that India Post will use its large network to run payments bank.
- The external advisory committee headed by Nachiket Mor submitted its findings on 6 July 2015.
- The applicant entities were examined for their financial track record and governance issues.
- On 19 August 2015, the Reserve Bank of India gave “in principle” licences to eleven entities to launch payments banks
    1) Aditya Birla Nuvo
    2) Airtel M Commerce Services
    3) Cholamandalam Distribution Services
    4) Department of Posts
    5) FINO PayTech
    6) National Securities Depository
    7) Reliance Industries
    8) Sun Pharmaceuticals

9) Paytm
10) Tech Mahindra
11) Vodafone MPesa

Note: Out of these, three have surrendered their licenses. First one being "Chalomandalam Distribution Services", then "Sun Pharmaceuticals" and the latest, "Tech Mahindra.

The "in-principle" license is valid for 18 months within which the entities must fulfil the requirements. They are not allowed to engage in banking activities within the period. The RBI will consider grant full licenses under Section 22 of the Banking Regulation Act, 1949, after it is satisfied that the conditions have been fulfilled.

SMALL BANKS:

Small finance banks are a type of niche banks in India. Banks with a small finance bank license can provide basic banking service of acceptance of deposits and lending. The aim behind these to provide financial inclusion to sections of the economy not being served by other banks, such as small business units, small and marginal farmers, micro and small industries and unorganised sector entities.

Regulations:

- The firms must have a capital of 100 crore. Existing nonbanking financial companies (NBFC), microfinance institutions (MFI) and local area banks (LAB) [Local area banks are non scheduled banks]
- They were set up with the twin objectives of providing an institutional mechanism for promoting rural and semi urban savings and for providing credit for viable economic activities in the local areas
- They were established as public limited companies in the private sector
- They are promoted either by individuals , corporate, trusts or societies
- The minimum paid up capital of such banks was Rs. 5 crores
- The promoter's contribution should be at least Rs. 2 crores
- Local area banks can operate and open their branches in a maximum of three geographically contiguous districts.
- They are governed by the provisions of Reserve Bank of India act 1934, Banking Regulation act 1949 and other relevant statutes.
- They are to be registered as public limited companies under the Indian companies act 1956
- Since they are non scheduled banks, they cannot borrow funds from Reserve Bank of India like other scheduled commercial banks are allowed to set up small finance banks. The promoters should have 10 years experience in banking and finance. The promoters stake in the paid-up equity capital will be 40% initially which must be brought down to 26% in 12 years. Joint ventures are not permitted. Foreign share holding will be allowed in these banks as per the rules for FDI in private banks in India.
- The banks will not be restricted to any region. 75% of its net credits should be in priority sector lending and 50% of the loans in its portfolio must in 25 lakh range.

Guidelines:

1. **Registration, licensing and regulations:** The small finance bank shall be registered as a public limited company under the Companies Act, 2013. It will be licensed under Section 22 of the Banking
    i. Regulation Act, 1949 and governed by the provisions of the Banking Regulation Act, 1949; Reserve
    ii. Bank of India Act, 1934; Foreign Exchange Management Act, 1999; Payment and Settlement
    iii. Systems Act, 2007; Credit Information Companies (Regulation) Act, 2005; Deposit Insurance and
    iv. Credit Guarantee Corporation Act, 1961; other relevant Statutes and the Directives, Prudential
    v. Regulations and other Guidelines/Instructions issued by RBI and other regulators from time to time. The small finance banks will be given scheduled bank status once they commence their operations, and found suitable as per Section 42 (6) (a) of the Reserve Bank of India Act, 1934.

2. **Objectives:** The objectives of setting up of small finance banks will be for furthering financial inclusion by (i) provision of savings vehicles primarily to un served and underserved sections of the population, and (ii) supply of credit to small business units; small and marginal farmers; micro and small industries; and other unorganised sector entities, through high technology low cost operations.

3. **Eligible promoters:** Resident individuals/professionals with 10 years of experience in banking and finance; and Companies and Societies owned and controlled by residents will be eligible as promoters to set up small finance banks. Existing Non Banking Finance Companies (NBFCs),Micro Finance Institutions (MFIs), and LABs that are owned and controlled by residents can also opt for conversion into small finance banks after complying with all legal and regulatory requirements of various authorities and if they conform to these guidelines. However, joint ventures by different promoter groups for the purpose of setting up small finance banks would not be permitted. As local focus and the ability to serve smaller customers will be the key criteria in licensing such banks, this may be a more appropriate vehicle for local players or players who are focussed on lending to un-served / underserved sections of the society. Accordingly, proposals from large public sector entities and industrial and business houses, including from NBFCs promoted by them, will not be entertained. Promoter / Promoter Groups as defined in the SEBI (Issue of Capital & Disclosure Requirements) Regulations, 2009 should be ‘fit and proper’ in order to be eligible to promote small finance banks. RBI would assess the ‘fit and proper’ status of the applicants on the basis of their past record of sound credentials and integrity; financial soundness and successful track record of professional experience or of running their businesses, etc. for at least a period of five years.

4. **Scope of activities:** The small finance bank, in furtherance of the objectives for which it is set up, shall primarily undertake basic banking activities of acceptance of deposits and lending to un-served and underserved sections including small business units, small and marginal farmers, micro and small industries and unorganised sector entities. It can also undertake other non-risk sharing simple financial services activities, not requiring any commitment of own fund, such as distribution of mutual fund units, insurance products, pension products, etc. with the prior approval of the RBI and after complying with the requirements of the sectoral regulator for such products. The small finance bank can also become a Category II Authorised Dealer in foreign exchange business for its clients' requirements. It cannot set up subsidiaries to undertake nonbanking financial services activities. The annual branch expansion plans of the small finance banks for the initial five years would need prior approval of RBI. The annual branch expansion plans should be in compliance with the requirement of opening at least 25 per cent of its branches in unbanked rural centres (population up to 9,999 as per the latest census). There will not be any restriction in the area of operations of small finance banks; however, preference will be given to those applicants who in the initial phase set up the bank in a cluster of under banked States / districts, such as in the North East, East and Central regions of the country. These applicants will not have any hindrance to expand to other regions in due course. It is expected that the small finance bank should primarily be responsive to local needs. After the initial stabilisation period of five years, and after a review, RBI may liberalize the requirement of prior approval for annual branch expansion plans and scope of activities of the small finance banks. The other financial and nonfinancial services activities of the promoters, if any, should be kept distinctly ring fenced and not comingled with the banking business. The small finance bank will be required to use the words "Small Finance Bank" in its name in order to differentiate it from other banks.

5. **Capital requirement:** The minimum paid-up equity capital for small finance banks shall be Rs. 100 crore. In view of the inherent risk of a small finance bank, it shall be required to maintain a minimum capital adequacy ratio of 15 per cent of its risk weighted assets (RWA) on a continuous basis, subject to any higher percentage as may be prescribed by RBI from time to time. Tier I capital should be at least 7.5 per cent of RWAs. Tier II capital should be limited to a maximum of 100 per cent of total Tier I capital. As small finance banks are not expected to deal with sophisticated products, the capital adequacy ratio will be computed under Basel Committee's standardised approaches.

6. **Promoter's contribution:** The promoter's minimum initial contribution to the paid-up equity capital of such small finance bank shall at least be 40 per cent. If the initial shareholding by promoter in the bank is in excess of 40 per cent, it should be brought down to 40 per cent within a period of five years. The promoter's minimum contribution of 40 per cent of paid-up equity capital shall be locked in for a period of five years from the date of commencement of business of the bank. Further, the promoter's stake should be brought down to 30 per cent of the paid-up equity capital of the bank within a period of 10 years, and to 26 per cent within 12 years from the date of

commencement of business of the bank. Proposals having diversified shareholding subject to the initial minimum shareholding of promoters and a time frame for listing of the bank will be preferred. However, after the small finance bank reaches the net worth of Rs.500 crore, listing will be mandatory within three years of reaching that net worth. However, small finance banks having net worth of below Rs.500 crore could also get their shares listed voluntarily, subject to fulfilment of the requirements of the capital markets regulator.

7. **Foreign shareholding:** The foreign shareholding in the small finance bank would be as per the Foreign Direct Investment (FDI) policy for private sector banks as amended from time to time. As per the current FDI policy, the aggregate foreign investment in a private sector bank from all sources will be allowed up to a maximum of 74 per cent of the paid-up capital of the bank (automatic up to 49 per cent and approval route beyond 49 per cent to 74 per cent). At all times, at least 26 per cent of the paid-up capital will have to be held by residents. In the case of Foreign Institutional Investors (FIIs) / Foreign Portfolio Investors (FPIs), individual FII / FPI holding is restricted to below 10 per cent of the total paid-up capital, aggregate limit for all FIIs /FPIs / Qualified Foreign Investors (QFIs) cannot exceed 24 per cent of the total paid-up capital, which can be raised to 49 per cent of the total paid-up capital by the bank concerned through a resolution by its Board of Directors followed by a special resolution to that effect by its General Body. In the case of NRIs, the individual holding is restricted to 5 per cent of the total paid-up capital both on repatriation and non-repatriation basis and aggregate limit cannot exceed 10 per cent of the total paid-up capital both on repatriation and non-repatriation basis. However, Non Resident Indian (NRI) holding can be allowed up to 24 per cent of the total paid-up capital both on repatriation and non-repatriation basis provided the banking company passes a special resolution to that effect in the General Body.

8. **Voting rights and transfer/acquisition of shares:** As per Section 12 (2) of the Banking Regulation Act, 1949, any shareholder’s voting rights in private sector banks are capped at 10 per cent. This limit can be raised to 26 per cent in a phased manner by the RBI. Further, as per Section 12B of the Act ibid, any acquisition of 5 per cent or more of paid-up share capital in a private sector bank will require prior approval of RBI. This will also apply to the small finance banks.

9. **Prudential norms:** The newly set up small finance banks should ensure that they put in place a robust risk management framework. The small finance bank will be subject to all prudential norms and regulations of RBI as applicable to existing commercial banks including requirement of maintenance of CRR and SLR. No forbearance would be provided for complying with the statutory provisions. In view of the objective for which small finance bank will be set up, it will be required to extend 75 per cent of its Adjusted Net Bank Credit (ANBC) to the sectors eligible for classification as priority sector lending (PSL) by RBI. While 40 per cent of its ANBC should be allocated to different subsectors under PSL as per the extant PSL prescriptions, the bank can

allocate the balance 35 per cent to any one or more subsectors under the PSL where it has competitive advantage. The maximum loan size and investment limit exposure to a single and group obligor would be restricted to 10 per cent and 15 per cent of its capital funds, respectively. Further, in order to ensure that the bank extends loans primarily to small borrowers, at least 50 per cent of its loan portfolio should constitute loans and advances of up to Rs.25 lakh. After the initial stabilisation period of five years, and after a review, RBI may relax the above exposure limits. In addition to the restrictions placed on banks' loans and advances to its directors and the companies in which its directors are interested under Section 20 of the Banking Regulation Act, 1949, the small finance bank is precluded from having any exposure to its promoters, major shareholders (who have shareholding of 10 per cent of paid-up equity shares in the bank), the relatives [as defined in Section 2 (77) of the Companies Act, 2013 and Rules made there under] of the promoters as also the entities in which they have significant influence or control (as defined under Accounting Standards AS 21 and AS 23).

10. **Additional conditions for NBFCs/MFIs/LABs converting into a bank:** An existing NBFC/MFI/LAB, if it meets the conditions under these guidelines, could apply to convert itself into a small finance bank, after complying with all legal and approval requirements from various authorities. In such a case, the entity shall have a minimum net worth of Rs. 100 crore or it shall infuse additional paid-up equity capital to achieve net worth of Rs. 100 crore. It may be noted that on conversion into a small finance bank, the NBFC / MFI will cease to exist and all its business which a bank can undertake should fold into the bank and the activities which a bank cannot statutorily undertake be divested / disposed of. Further, the branches of the NBFC / MFI should either be converted into bank branches or be merged / closed as per the business plan. The small finance bank and the NBFC / MFI cannot coexist. Banks are precluded from creating floating charge on their assets. For such NBFCs / MFIs, which succeed in obtaining licences to convert into small finance banks, if they have created floating charges on their assets for secured borrowings which stand in their balance sheets on the day of conversion into a bank, RBI will permit grandfathering of such borrowings till their maturity, subject to imposition of additional capital charge in order to protect the interest of the depositors. If the existing NBFCs / MFIs / LABs have diluted the promoters' shareholding to below 40 per cent, but above 26 percent, due to regulatory requirements or otherwise, RBI may not insist on the promoters' minimum initial contribution as indicated in paragraph 6 of the guidelines.

11. **Business plan:** The applicants for small finance bank licences will be required to furnish their business plans along with project reports with their applications. The business plan will have to address how the bank proposes to achieve the objectives behind setting up of small finance banks and in the case of an NBFC / MFI applicant, how the existing business of NBFC / MFI will fold into the bank or divested / disposed of. The business plan submitted by the applicant should be realistic and viable. In case of deviation from the stated business plan after issue of licence, RBI may consider restricting the bank's expansion, effecting change in management and imposing other penal measures as may be necessary.

12. **Corporate governance:** The Board of the small finance bank should have a majority of independent Directors. The bank should comply with the corporate governance guidelines including ‘fit and proper’ criteria for Directors as issued by RBI from time to time.

13. **Other conditions:** If a promoter setting up a small finance bank desires to set up a Payments Bank, it should set up both types of banks under a Non Operative Financial Holding Company (NOFHC) structure. However, a promoter will not be granted licences for both universal bank and small finance bank even if the proposal is to set them up under the NOFHC structure. Individuals (including relatives) and entities other than the promoters will not be permitted to have shareholding in excess of 10 per cent of the paid-up equity capital of the bank. In case of existing NBFCs / MFIs / LABs converting into small finance bank, where there is shareholding in excess of 10 per cent of the paid-up equity capital by entities other than the promoters, RBI may consider providing time up to 3 years for the shareholding to be brought down to 10 per cent. The small finance bank cannot be a Business Correspondent (BC) for another bank. However, it can have its own BC network. The operations of the bank should be technology driven from the beginning, conforming to generally accepted standards and norms; while new approaches (such as for data storage, security and real time data updating) are encouraged, a detailed technology plan for the same should be furnished to RBI. The bank should have a high powered Customer Grievances Cell to handle customer complaints. The small finance banks will come under the purview of RBI’s Banking Ombudsman Scheme, 2006. The compliance of terms and conditions laid down by RBI is an essential condition of grant of licence. Any noncompliance will attract penal measures including cancellation of licence of the bank.

14. **Transition path:** The small finance bank may choose to continue as a differentiated bank. If it aspires to transit into a universal bank, such transition will not be automatic, but would be subject to it applying to RBI for such conversion and fulfilling minimum paid-up capital / net worth requirement as applicable to universal banks; its satisfactory track record of performance as a small finance bank for a minimum period of five years and the outcome of RBI’s due diligence exercise. On transition into a universal bank, it will be subjected to all the norms including NOFHC structure as applicable to universal banks.

History

- On 17 July 2014, the Reserve Bank of India (RBI) released the draft guidelines for small finance banks, seeking comments for interested entities and the general public.
- The final guidelines were released by RBI on 27 November 2014. It was also announced that interested parties should submit applications before 16 January 2015.
- In February 2015, RBI released the list of entities which had applied for a small finance bank license.
- There were 72 applicants.

- It was also announced that an external advisory committee headed by Usha Thorat will evaluate the license applications.
- On 17 September 2015, The Reserve Bank of India (RBI) announced that it had given provisional licenses to 10 entities that would have to convert into Small Finance Banks within one year.
- 8 out of these 10 entities are microfinance NBFCs reiterating RBIs agenda of financial inclusion.

  The names of the licensees are as below

  1) Ujjivan
  2) Janalakshmi
  3) Equitas
  4) AU Financiers
  5) Capital LAB
  6) Disha
  7) ESAF
  8) RGVN
  9) Suryoday
  10) Utkarsh

Cooperative Banks and its different types:

The cooperative banking sector is the oldest segment of the Indian Banking System. The financing needs of India's urban, semi-urban and rural areas retail trade, agriculture, self-employed businessman and small industry are catered by them.

TYPES OF COOPERATIVE BANKS:

1. PRIMARY AGRICULTURE CREDIT SOCIETIES:

Operate in villages. A cooperative credit society can be formed by more than ten persons in most of the states. Deposits are accepted by these societies from their members and they provide them short-term and medium term loans.

2. CENTRAL COOPERATIVE BANK:

These banks provide financial assistance and supervise the primary cooperative societies of a district or any part of it.

3. STATE COOPERATIVE BANK:

There is a main cooperative bank in every state that runs and lends money all the central cooperative banks in that state.

4. PRIMARY COOPERATIVE AGRICULTURE AND RURAL DEVELOPMENT BANK:

Provide long term loans by mortgaging immovable property of its debtors as security.

5. STATE COOPERATIVE AGRICULTURE AND RURAL DEVELOPMENT BANK:

Whole State comes under its jurisdiction and it advance loans to Primary Cooperative Agriculture and Rural Development Banks.

6. URBAN COOPERATIVE BANK:

These banks operate in urban areas and accept deposits from the public and also advance loans to them. Supervised by the RBI and managed by the State governments.

1.2. History of banking business in India

History of Banking in India - Introduction According to the Banking Companies Act of 1949, Banking is defined as, accepting for the purpose of lending or investment of deposit money from the public, repayable on demand or otherwise and withdrawable by cheque draft, order or otherwise. It also defines Bank as an institution dealing in money and credit. It safeguards the savings of the public and gives loans and advances.

The main functions of the banking sector are as following:

- It provides liquidity for economic growth of a country
- It acts as the main pillar of the whole financial system
- It offers safety for the depositors who want to deposit their savings in the Bank
- It offers liquidity for the borrowers both on short and long-term basis based on their need
- It provides credit or loan to dealers, households, small as well as large business houses
- It helps to manage all the financial transactions between different parties
- It provides the Government with the flexibility to reach to the masses across the country

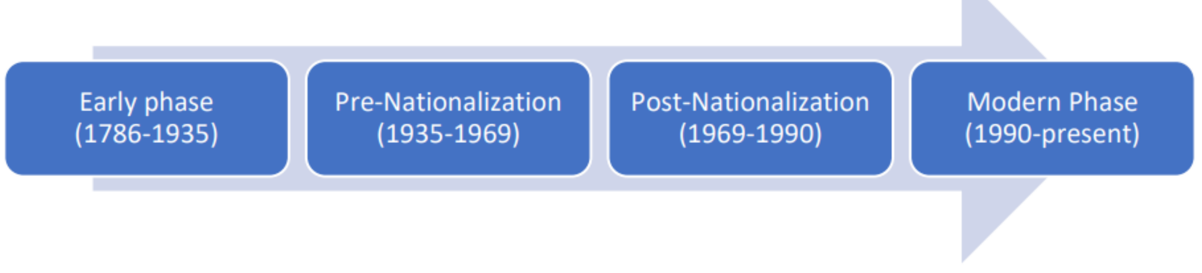
The banking sector was developed during the British era. British East India Company established three banks,

1. Bank of Bengal – 1809
2. Bank of Bombay – 1840
3. Bank of Madras – 1843

These three banks were later amalgamated and called Imperial Bank, which was taken over by SBI in 1955. The Reserve Bank of India was established in 1935, followed by the Punjab National Bank, Bank of India, Canara Bank and Indian Bank.

In 1969, 14 major banks were nationalized and in 1980, 6 major private sector banks were taken over by the government.

Indian banking system, over the years, has gone through various phases. For ease of study and understanding, it can be broken into four phases:-



1. **Early Phase**: During the first phase, the growth was very slow and banks experienced periodic failures during the Early Phase between. There were approximately 1100 banks, mostly small which failed in the early phase.

2. **Pre-Nationalisation Phase**: Breakthrough happened in this phase, was Reserve Bank of India. Reserve Bank of India (RBI) was created with the central task of maintaining monetary stability in India. This phase of Indian banking was eventful and was a phase of restructuring, regulation. However, despite these provisions, control and regulations, banks in India except the State Bank of India, continued to be owned and operated by private persons
3. **Post Nationalisation Phase**: This phase of Indian banking not so happening for entry of new banks. Undoubtedly, it was a phase of expansion, consolidation and increment in many ways. The banking sector grew at a phenomenal rate, fruits of nationalization were evident, and the common man was now banking with great trust.
4. **Modern Phase:** This is the phase of "New Generation" tech-savvy banks. This phase can be called as "The Reforms Phase". Currently, banking in India is generally fairly mature in terms of supply, product range and reach-even though reach in rural India still remains a challenge for the private sector and foreign banks.

   Prof K.V. Bhanu Murthy has also segregated the Indian banking periods into four eras. These are:

   - Early historical and formative era: 1770-19052
   - Pre-independence era: 1906-19463
   - Post-independence regulated era: 1947-19934
   - Post-independence deregulated era from 1993 onwards

The Banking system of the country is the base of the economy and economic development of the country. It is the most leading part of the financial sector of the country as it is responsible for more than 70 % of the funds flowing through the financial sector in the country.

The banking system in the country has three primary functions:

- Operations of Payment system
- Depositor and protector of people's savings
- Issue loans to individual and Companies
- The Banking system in India can be categorized in two phases
- Pre-Independence Phase (1786-1947)
- Post- Independence Phase (1947 to till date)

The post-Independence period may further be divided into three phases-

- Pre-nationalization Period (1947 to 1969)
- Post nationalization Period (1969 to 1991)
- Liberalization Period (1991 to till date)

Pre-Independence Phase (1786-1947)

The origin of the Banking system in India can be traced with the foundation of Bank of Calcutta in 1786. The Banking in India originates in the last decade in the 18th century with the foundation of the English Agency houses in Bombay and Calcutta (now Kolkata).

- Three presidency banks Bank of Bengal, Bank of Bombay and Bank of Madras established in the 19th Century under the charter of the British East India Company.

- In 1935, the presidency banks merge together and formed a new bank named Imperial Bank of India.
- The Imperial Bank of India subsequently named the State Bank of India.
- The first Indian-owned Allahabad Bank was set up in 1865 in Allahabad.
- In 1895, the Punjab National Bank was established in 1895.
- The Bank of India founded in 1906 in Mumbai.
- Many more commercial banks such as Canara Bank, Indian Bank, Central Bank of India, Bank of Baroda and Bank of Mysore were established between 1906 and 1913 under Indian ownership.
- The central Bank of India, RBI establish in 1935 on the recommendation of Hilton-Young Commission.

At that time, the Banking system was only covered the urban population and need of rural and agriculture sector was totally neglected.

Post- Independence Phase (1947 to till)

- At the time independence, the entire Banking sector was under private ownership. The rural population of the country had to dependent on small money lenders for their requirements. To solve these issues and better development of the economy the Government t of India nationalized the Reserve Bank of India in 1949.
- In 1955 the Imperial Bank of India was nationalized and named the State Bank of India.
- The Banking Regulation Act enacted in 1949.
- Nationalization Period (1969 to 1991)
- In 1969, Government of India nationalized 14 major banks whose national deposits were more than 50 crores.
  1. Allahabad Bank
  2. Bank of India
  3. Punjab National Bank
  4. Bank of Baroda
  5. Bank of Maharashtra
  6. Central Bank of India
  7. Canara Bank
  8. Dena Bank
  9. Indian Overseas Bank
  10. Indian Bank
  11. United Bank
  12. Syndicate Bank
  13. Union Bank of India
  14. UCO Bank

The Indian Banking system immensely developed after nationalization but the rural and weaker section of the society was still not covered under the system.

To solve these issues, the **Narasimham Committee** in 1974 recommended the establishment of **Regional Rural Banks (RRB)**. On **2nd October 1975, RRBs were established** with an objective to extend the amount of credit to the rural section of the society.

- Six more banks further nationalized in the year 1980. With the second wave of nationalization, the target of priority sector lending was also raised to 40%.
  1. Andhra Bank
  2. Corporation Bank
  3. New Bank of India
  4. Oriental Bank of Commerce
  5. Punjab & Sindh Bank
  6. Vijaya Bank

Liberalization Phase (1990 to till)

In order to improve financial stability and profitability of Public Sector Banks, the Government of India set up a committee under the chairmanship of **Shri. M. Narasimham**. The committee recommended several measures to reform banking system in the country.

- The major thrust of the recommendations was to make banks competitive and strong and conducive to the stability of the financial system.
- The committee suggested for no more nationalization of banks.
- Foreign banks would be allowed to open offices in India either as branches or as subsidiaries.
- In order to make banks more competitive, the committee suggested that public sector banks and private sector banks should be treated equally by the Government and RBI.
- It was emphasized that banks should be encouraged to abandon the conservative and traditional system of banking and adopt progressive function such as merchant banking and underwriting, retail banking, etc.
- Now, foreign banks and Indian banks permitted to set up joint ventures in these and other newer forms of financial services.
- 10 Privates players got a license from the RBI to entry in the Banking sector. These were Global Trust Bank, ICICI Bank, HDFC Bank, Axis Bank, Bank of Punjab, IndusInd Bank, Centurion Bank, IDBI Bank, Times Bank and Development Credit Bank.
- The Government of India accepted all the major recommendation of the committee.

Recent Development in Indian Banking Sector:

- Kotak Mahindra Bank and Yes Bank got a license from RBI to entry in the system in the year 2003 and 2004.
- In 2014, RBI grants in-principle approval to IDFC and Bandhan Financial Services to set up banks.
- Today, Indian Banking industry is one of the most growing flourishing industries. Banking systems of any country need to be effective, efficient as it plays the active in the economic development of the country.

1.3. Types of accounts:

Bank Account: It is an arrangement made with a bank where by one may deposit and withdraw money and in some cases be paid interest. Generally Bank can accept both Demand and Time deposits. All type of deposits is Liability for the Banks.

Demand Deposits: Demand Deposit accounts offer greater liquidity and ease of access as compared to term deposits but pay lower Interest rates and they may also include various fees for handling the account. Depositors can withdraw any or all of the funds in a demand deposit account at any time without penalty or prior notice required. Funds a depositor may need to access at any time that provides the depositor with sufficient personal liquidity to handle his regular expenses should kept in a demand deposit account.

Example of demand deposit accounts include Regular checking accounts, Savings accounts or money market accounts

Time / Term Deposits: These are investment deposits made for a predetermined period of time, ranging from a few months to several years. The depositor receives a predetermined rate of interest on the term deposit over the specified time period. Funds deposited for longer time periods command a higher interest rate. Term deposit accounts pay a higher rate of interest than traditional savings accounts.

Funds cannot be withdrawn from a term deposit account until the end of the chosen time period without incurring a financial penalty, and withdrawals often require written notice in advance. At the end of the time period, the depositor has the choice of withdrawing deposited funds plus earned interest , or rolling over the funds into a new term deposit. The Most common form of a term deposit is a bank Certificate of Deposit(CD) or Fixed Deposit (FD) or Recurring Deposit (RD).

Traditionally banks in India have four types of deposit accounts, namely Current Accounts, Saving Banking Accounts, Recurring Deposits and, Fixed Deposits. However, in recent years, due to ever increasing competition, some banks have introduced new products, which combine the features of above two or more types of deposit accounts. These are known by different names in different banks, e.g 2-in-1 deposits, Smart Deposits, Power Saving Deposits, Automatic Sweep Deposits etc. However, these have not been very popular among the public.

Note: Total of Demand and Time Liabilities are called as NDTL (Net Demand and Time Liabilities)

1. **TYPES OF General/ Common BANK ACCOUNTS IN INDIA (Deposit Accounts)**

   A.CURRENT DEPOSITS / ACCOUNTS

   B.SAVING BANK / Saving Fund DEPOSITS / ACCOUNTS

   C.RECURRING DEPOSITS / ACCOUNTS

   D. FIXED DEPOSITS / ACCOUNTS OR TERM DEPOSITS

A. **Current Account:**

Current Accounts are basically meant for businessmen and are never used for the purpose of investment or savings. These deposits are the most liquid deposits and there are no limits for number of transactions or the amount of transactions in a day. Most of the current accounts are opened in the names of firm / company accounts. Cheque book facility is provided and the account holder can deposit all types of the cheques and drafts in their name or endorsed in their favour by third parties. No interest is paid by banks on these accounts. On the other hand, banks charge certain service charges, on such accounts.

Features of Current Accounts:

i. The main objective of Current Account holders in opening these accounts is to enable them (mostly businessmen) to conduct their business transactions smoothly.
ii. There are no restrictions on the number of times deposit in cash / cheque can be made or the amount of such deposits;
iii. Usually banks do not have any interest on such current accounts. However, in recent times some banks have introduced special current accounts where interest (as per banks' own guidelines) is paid
iv. The current accounts do not have any fixed maturity as these are on continuous basis accounts

B. Savings Bank Account: This account is called as King of Accounts

These deposits accounts are one of the most popular deposits for individual accounts. These accounts not only provide cheque facility but also have lot of flexibility for deposits and withdrawal of funds from the account. Most of the banks have rules for the maximum number of withdrawals in a period and the maximum amount of withdrawal, but hardly any bank enforces these. However, banks have every right to enforce such restrictions if it is felt that the account is being misused as a current account. Till 24/10/2011, the interest on Saving Bank Accounts was regulated by RBI and it was fixed at 4.00% on daily balance basis. However, w.e.f 25th October, 2011, RBI has deregulated Saving Fund account interest rates and now banks are free to decide the same within certain conditions imposed by RBI. Under directions of RBI, now banks are also required to open no frill accounts (this term is used for accounts which do not have any minimum balance requirements). Although Public Sector Banks still pay only 4% rate of interest, some private banks like Kotak Bank and Yes Bank pay between 6% and 7% on such deposits. From the FY 2012-13, interest earned up to Rs 10,000 in a financial year on Saving Bank accounts is exempted from tax.

C. Recurring Deposit Accounts

These are popularly known as RD accounts and are special kind of Term Deposits and are suitable for people who do not have lump sum amount of savings, but are ready to save a small amount every month. Normally, such deposits earn interest on the amount already deposited (through monthly instalments) at the same rates as are applicable for Fixed Deposits / Term Deposits. These are best to someone who wishes to create a fund for their child's education or marriage of daughter or buy a car without loans or save for the future.

Under these type of deposits, the person has to usually deposit a fixed amount of money every month (usually a minimum of Rs,100/- p.m.). Any default in payment within the month attracts a small penalty. However, some Banks besides offering a fixed instalment RD, have also introduced a flexible / variable RD. Under these flexible RDs the person is allowed to deposit even higher amount of instalments, with an upper limit fixed for the same e.g. 10 times of the minimum amount agreed upon.

These accounts can be funded by giving Standing Instructions by which bank withdraws a fixed amount on a fixed date of the month from the saving bank of the customer (as per his mandate), and the same is credited to RD account.

Recurring Deposit accounts are normally allowed for maturities ranging from 6 months to 120 months. A Pass book is usually issued wherein the person can get the entries for all the deposits made by him / her and the interest earned. Banks also indicate the maturity value of the RD assuming that the monthly instalments will be paid regularly on due dates. In case instalment is delayed, the interest payable in the account will be reduced and some nominal penalty charged for default in regular payments. Premature withdrawal of accumulated amount permitted is usually allowed (however, penalty may be imposed for early withdrawals). These accounts can be opened in single or joint names. Nomination facility is also available.

The RD interest rates paid by banks in India are usually the same as payable on Fixed Deposits, except when specific rates on FDs are paid for particular number of days e.g. 500 days, 555 days, 1111 days etc i.e. these are not ending in a quarter.

D. Fixed Deposit Accounts in India or Term Deposits

All Banks in India offer fixed deposits schemes with a wide range of tenures for periods from 7 days to 10 years. These are also popularly known as FD accounts. However, in some other countries these are known as "Term Deposits" or even called "Bond". The term "fixed" in Fixed Deposits (FD) denotes the period of maturity or tenor. Therefore, the depositors are supposed to continue such Fixed Deposits for the length of time for which the depositor decides to keep the money with the bank. However, in case of need, the depositor can ask for closing (or breaking) the fixed deposit prematurely by paying a penalty (usually of 1%, but some banks either charge less or no penalty). (Some banks introduced variable interest fixed deposits. The rate of interest on such deposits keeps on varying with the prevalent market rates i.e. it will go up if market interest rate goes and it will come down if the market rates fall. However, such types of fixed deposits have not been popular till date).

The rate of interest for Fixed Deposits differs from bank to bank (unlike earlier when the same were regulated by RBI and all banks used to have the same interest rate structure. The present trends indicate that private sector and foreign banks offer higher rate of interest.

The earlier trend that private sector and foreign banks offer higher rate of interest is no more valid these days. However, now a day small banks are forced to offer higher rate of interest to attract more deposits. Usually a bank FD is paid in lump sum on the date of maturity. However, most of the banks have also facility to pay/ credit interest in saving account at the end of every quarter. If one desires to get interest paid every month, then the interest paid will be at a marginal discounted rate. In the changed computerized environment, now the Interest payable on Fixed Deposit can also be easily transferred on due dates to Savings Bank or Current Account of the customer.

2. Development Oriented Accounts

A. BSBDA: Basic Savings Bank Deposit Account

B. Zero balance account

C. Dormant Account

D. CASA- Current Account and Savings Account

A. Basic Savings Bank Deposit Account (BSBDA)

The Basic Savings Bank Deposit Account -BSBDA allows the customer to bank with a zero minimum balance requirement. All the existing 'No-frills' accounts opened by the banks are now converted into BSBDA in compliance with the guidelines issued on August 22, 2012 by the Reserve Bank of India (RBI), Under the Basic Savings Bank Deposit Account (BSBDA) scheme of Reserve Bank of India:

The Basic Savings Bank Deposit Account should be considered as a normal banking service available to all customers (Any individual, including poor or those from weaker section of the society), through branches.

- BSBDA guidelines are applicable to "all scheduled commercial banks in India, including foreign banks having branches in India".
- The services available in the account will include deposit and withdrawal of cash at bank branch as well as Free ATMs-cum-Debit Card; receipt/credit of money through electronic payment channels or by means of deposit/collection of cheques drawn by Central/State Government agencies and departments.
- There will be no limit on the number of deposits that can be made in a month, account holders will be allowed a maximum of four withdrawals in a month, including ATM withdrawals.
- No charge will be levied for non-operation/activation of in-operative 'Basic Savings Bank Deposit Account'.
- Holders of 'Basic Savings Bank Deposit Account' will not be eligible for opening any other savings bank deposit account in that bank. If a customer has any other existing savings bank deposit account in that bank, he/she will be required to close it within 30 days from the date of opening a 'Basic Savings Bank Deposit Account'.
- One can have Term/Fixed Deposit, Recurring Deposit etc., accounts in the bank where one holds 'Basic Savings Bank Deposit Account'.
- The 'Basic Savings Bank Deposit Account' would be subject to RBI instructions on Know Your Customer (KYC) / Anti-Money Laundering (AML) for opening of bank accounts issued from time to time. If such account is opened on the basis of simplified KYC norms, the account would additionally be treated as a 'Small Account'.

Limits in BSBDA (Accounts with introduction/ Small Accounts):

- Aggregate of all credits in a financial year does not exceed Rs.1.00 lac
- The aggregate of all withdrawals and transfers in a month does not exceed Rs.10,000/-

- Balance at any point of time does not exceed Rs.50,000/-.
- The aim of introducing BSBDA is part of the efforts of RBI for furthering financial inclusion objectives.
- Tagged with Basic Savings Bank Deposit Account BSBDA Limits in BSBDA RBI Reserve Bank of India

B. Zero balance account

In finance, a Zero Balance Account (ZBA) is a system of cash pooling (to consolidate the cash balances of several subsidiaries of a single company). This system is designed to leave in the current accounts of the subsidiaries that minimum amounts to be able to deal with their debts contracted.

The main advantage of this system is to centralize the cash to be able to put it to better interest rates .This system may have the disadvantage of not allowing enough independence to financial subsidiaries.

C. Dormant Account or an Inoperative Account:

In layman's language dormant means inactive and inoperative means which is not being operated i.e. no transactions have been undertaken recently. In terms of RBI guidelines “A savings as well as current account should be treated as inoperative / dormant if there are no transactions in the account for over a period of two years". Further clarifying the issue RBI says "for the purpose of classifying an account as ‘inoperative’ both the type of transactions i.e., debit as well as credit transactions induced at the instance of customers as well as third party should be considered. However, the service charges levied by the bank or interest credited by the bank should not be considered". However, when the interest on Fixed Deposit account is credited to the Savings Bank accounts as per the mandate of the customer, it is treated as a customer induced transaction. However, it may be mentioned that some banks had certain internal guidelines / periods before an account can be termed as dormant and / or inoperative. Banker’s need to check their internal circulars for this purpose, but the above period of two years is applicable as per RBI guidelines. Therefore, as per RBI guidelines, there is no difference between dormant accounts and inoperative accounts.

Section 26 of the Banking Regulation Act, 1949 provides, inter alia, that every banking company shall, within 30 days after close of each calendar year submit a return in the prescribed form and manner to the Reserve Bank of India as at the end of each calendar year (i.e., 31st December) of all accounts in India which have not been operated upon for 10 years. Such deposits are considered as unclaimed deposits. Thus, banks were complying with these guidelines. Slowly, the amount of unclaimed deposits has increased to a level which came to severe criticism in the media and some other reports. To check this trend, RBI has initiated a move and wanted banks to play a pro-active role so that unclaimed deposits can be nipped in the bud itself. Thus, it has issued certain guidelines to banks as to how to monitor such dormant and in operative accounts.

In terms of RBI guidelines, banks are required to make an annual review of accounts in which there are no operations (i.e., no credit or debit other than crediting of periodic interest or debiting of service charges) for more than one year. In case there have no "transactions", the bank is required to inform the account holder to activate the account by putting through any single debit or credit transaction which can also be put through a third party. If the account is still not activated and no reply is received, the bank will classify the account as dormant at the end of two years from the date of last transaction. RBI has also specified the procedure to be followed in case the letter sent is returned back.

However, where the account holder replies and gives the reasons for not operating the account, bank will continue classifying the same as an operative account for one more year within which period the account holder can operate the account. However, if the account holder still does not operate the same during the extended period, the account will be classified as inoperative at the end of the extended period.

- Interest on savings bank accounts should be credited on regular basis whether the account is operative or not.
- Banks are also advised to ensure that the amounts lying in inoperative accounts ledger are properly audited by the internal auditors / statutory auditors of the bank.
- The purpose for segregation of inoperative accounts is to reduce the risk of frauds etc. The classification is done merely to bring the attention of dealing staff about the increased account in such an account. Thus, transactions in such accounts may be monitored at a higher level both from the point of view of preventing fraud and making a Suspicious Transactions Report. However, the entire process remains un-noticeable by the customer.
- However, the bank is expected to exercise due diligence as to the genuineness of the transaction, verification of the signature, identify etc., and use its discretion while making payment of such cheques.
- Bank can charge for account remaining as dormant as per the schedule of charges declared by the bank
- However, banks can not charge any fee /charges for converting a dormant / inoperative account as operative.

D. Casa Ratio: Casa is basically the current and savings account deposits.

The CASA ratio shows how much deposit a bank has in the form of current and saving account deposits in the total deposit.

- If the CASA ratio is higher than it means that a higher portion of the deposits have come from current and savings deposit.
- This means that the bank is getting money at low cost, since no interest is paid on the current accounts and the interest paid on savings account is usually low.

- Current and Saving Accounts are demand deposits and therefore pay lower interest rates compared to term deposits where the rates are higher.
- In India, interest rates paid on current and savings account deposits is administered by banking regulator - the Reserve Bank of India.
- Interest rate paid on Casa is much lower compared to other deposits like term deposits or recurring deposits. While banks do not pay any interest on current account, interest paid on savings account deposit is 4%.
- Banks therefore make maximum effort to increase the share of Casa on their books to reduce their overall cost of deposits. HDFC Bank has the highest share of Casa to total deposits at 52%, followed by the State Bank of India at 48% and ICICI Bank at 45%.

Casa mean for customers:

Recently interest paid on savings account deposits is 4%. Banks pay interest on savings deposits on a daily basis rather than paying on the minimum balance maintained by them in six months. As a result, savings account customers earn better returns compared to what they earned a year ago.

Further, interest earned on savings account deposits does not attract TDS (tax deduction at source). Interest income above 10,000 a year attracts TDS of 10% in case of term deposits. However, there is no major benefit for current account deposits, which is mainly maintained by corporate and traders.

Disadvantages of high CASA:

These deposits can move out of banks' books anytime, leading to asset-liability mismatches. While in case of term deposits, banks are almost certain that the depositor may not withdraw money before the maturity of the deposit and may also renew the deposit on maturity.

Further, to finance long-term projects, banks need to have long-term liabilities on their books to avoid mismatches. Banks cannot rely on Casa deposits to fund long-term loans.

3. Account for Investment: De-mat account

In India, shares and securities are held in electronically in a dematerialized (or "De-mat") (/dimæt/;) account, instead of the investor taking physical possession of certificates. A Dematerialized account is opened by the investor while registering with an investment broker (or sub-broker). The Dematerialized account number is quoted for all transactions to enable electronic settlements of trades to take place. Every shareholder will have a Dematerialized account for the purpose of transacting shares.

Access to the Dematerialized account requires an internet password and a transaction password. Transfers or purchases of securities can then be initiated. Purchases and sales of securities on the Dematerialized account are automatically made once transactions are confirmed and completed.

Advantages of De-mat

- The bonus/right shares allotted to the investor will be immediately credited into his account. There is no risk due to loss on account of fire, theft or mutilation. Transaction costs are usually lower than that in the physical segment.
- A D-mat account also helps avoid problems typically associated with physical share certificates. For example: delivery failures caused by signature mismatch, postal delays and loss of certificate during transit.
- Further, it eliminates the risks associated with forgery and due to damaged stock certificates. D-mat account holders also avoid stamp duty (as against 0.5 per cent payable on physical shares) and filling up of transfer deeds.
- The biggest advantage of having d-mat account is that you don't have to pay for stamp since these are electronically stored which reduces the transaction cost.
- Easy and convenient way to hold securities immediate transfer of securities.
- No stamp duty on transfer of securities Safer than paper-shares (earlier risks associated with physical certificates such as bad delivery, fake securities, delays, thefts etc. are mostly eliminated)
- Reduced paperwork for transfer of securities Reduced transaction cost No "odd lot" problem: even one share can be sold Change in address recorded with a DP gets registered with all companies in which investor holds securities eliminating the need to correspond with each of them separately.
- Transmission of securities is done by DP, eliminating the need for notifying companies. Automatic credit into d-mat account for shares arising out of bonus/split, consolidation/merger, etc. A single d-mat account can hold investments in both equity and debt instruments.
- Traders can work from anywhere (e.g. even from home).

4. Types for accounts by the domestic banks with foreign banks

A. Nostro A/C

B. Vostro A/C

C. LORO Account

A. Nostro A/C: [Ours Account with You]

Nostro Account is a Current account maintained by a domestic bank/dealer with a foreign bank in foreign currency. For example, Current Account of SBI Bank (an Indian bank) with Swiss Bank in Swiss Franc (CHF) currency is a Nostro A/C.

B. Vostro A/C: [Yours Account with us]

Vostro A/C is a Current account maintained by a foreign bank with domestic bank in Rupee currency. For example: Account of Swiss bank in India with SBI in Rupee Currency.

C. Loro A/C: [Our Account of their money with you]

Loro Account is a Current Account Maintained by one Domestic Bank on behalf of other domestic bank in foreign bank in foreign currency. In other word Loro Account is a Nostro Account for one bank who opened the bank and Loro Account for other bank who refers first one account. For Example: SBI opened Current Account with Swiss bank. If PNB refers that account of SBI for its correspondence, then it is called Loro Account for PNB and it is Nostro Account for SBI.

5. Types of accounts for Non Residencies of Indians:

A. FCNR a/c [Foreign Currency (Non-Resident) a/c]

B. NRE a/c [Non-Resident(External) Rupee a/c]

C. NRO (Non-Resident Ordinary Rupee a/c)

A. FCNR a/c :

Non Resident Indians (NRIs) / Person of Indian Origin (PIOs) being Indian Citizens as also foreign citizens of Indian origin can open foreign currency deposit accounts under Foreign Currency (Non-Resident) Accounts (Banks) Scheme. FCNR (B) Account or Foreign Currency Non-Resident Bank Accounts are similar to any NRE account except that the funds are held in foreign currency. These accounts can only be maintained in the form of term deposits. FCNR (Bank) accounts are only in the form of term deposits of 1 to 5 years.

B. Non-Resident External (NRE) account:

It is a bank account that's opened by depositing foreign currency at the time of opening a bank account. This currency can be tendered in the form of traveller's checks or notes.

C. Non-Resident Ordinary (NRO) account:

It is the normal bank account opened by an Indian going abroad with the intention of becoming an NRI. NRO account can also be opened by sending remittances by NRI from his residing country or by transferring funds from his other NRO account. It offers the same facilities as an NRE account, except that any repatriation done through this account should be reported to RBI by filling up prescribed forms.

Below is a quick comparison between NRE, NRO and FCNR (Bank) accounts:

Particulars	**FCNR a/c [Foreign Currency (Non-Resident) a/c]**	**NRE a/c [Non-Resident (External) Rupee a/c]**	**NRO (Non-Resident Ordinary Rupee a/c)**
Who can open an account	NRIs and OCBs	NRIs and OCBS	Any person resident outside India

Joint account of two or more NRIs	Permitted	Permitted	Permitted
Joint account with another person resident in India	Not permitted	Not permitted	Permitted
Currency in which account denominated	Pound Sterling US Dollar, Jap. Yen, or Euro	Indian Rupees	Indian Rupees
Repatriability: Principal	Freely repatriable	Freely repatriable	Freely repatriable
Repatriability: Interest	Freely repatriable	Not repatriable	Freely repatriable
Foreign Currency Risk	Account holder is protected against changes in INR value vis-à-vis the currency in which the account is denominated	Account holder is exposed to the fluctuations in the value of INR	Account holder is exposed to the fluctuations, in the value of INR to the extent of interest amount
Type of accounts	Term deposits only	Current Savings Recurring Fixed Deposits	Current Savings Recurring Fixed Deposits
Period for fixed deposits	For terms not less than 1 year and not exceeding 3 years	For the periods as announced by the deposit taking bank	For the periods as announced by the deposit taking bank
Rate of interest	Banks are free to determine interest rates within the ceiling, if any, prescribed by the Reserve Bank	Banks are free to determine interest rates.	Banks are free to determine interest rates.

- NRI is a person resident outside India who: is citizen of India, or is a citizen of any country other than Bangladesh or Pakistan if he at any time held Indian passport, or he or either his parents or any of his grandparents were citizen of India by virtue of the constitution of India or the Citizenship Act, 1955 (57 of 1955), or a person is a spouse of an Indian citizen or a person referred to in sub-clause (a) or (b) above

- OCB is defined as: "a company, partnership, firm, society or any other corporate body owned directly or indirectly to the extent of at least 60% by non-resident Indian and includes overseas Trust in which not less than 60% beneficial interest is held by non-resident Indians directly or indirectly but irrevocably".

Type of Customer for a Bank:

Every bank has two categories of customers 1. Individual Customer 2. Institutional Customer

1. Individual or Personal customer are based on different basis, for instance Male/Female/Transgender based on gender, Married Women/Un married/Widow women based on Female categories, Salaries/Self employed/Farmer etc based on occupation, Rural/ semi urban/urban/ NRI etc based on locality of the customer etc.
2. Institutional or Organisational Customer also categorised based on its establishment for example HUF, Solo Proprietary, Partnership companies, Micro Institutions, SSI,MSI,LSI, Educational institution, NPO, Trust, NGO etc

The following people cannot be a customer for the banks:

1. The person whose age is below 10 years (10 years old can open a account as children account, general age limit to open an account is 18 years)
2. Idiots like Noxell, Terrorists, psychos and Criminals
3. Lunatics and Drunkards

KYC Criteria to open an account

The Reserve Bank of India (RBI) introduced KYC guidelines for all banks in 2002 & RBI directed all banks to compliant these guidelines by 31st December 2005. KYC means “Know Your Customer”. It is a process by which banks obtain information about the identity and address of the customers. This process helps to ensure that banks’ services are not misused. The KYC procedure is to be completed by the banks while opening accounts and also periodically update the same. The bank is required to update KYC data of high-risk customer once in 2 years, for the medium-rick customer once in 8 years and for the low-risk customer once in 10 years.

KYC requirement for opening a bank account is the roof of Identity and proof of address and Income proof with a recent photograph.

India’s first knowing your customer registration agency “KRA (KYC Registration Agency)” was launched at Bombay Stock Exchange (BSE) in 2012 by UK Sinha (SEBI Chairman).

Officially Valid Document (OVD)

1. The Aadhar Card
2. Voter’s Identity Card
3. PAN Card
4. Driving license
5. Passport
6. The NREGA job card issued and duly signed by an officer of the State Government.

Note : PAN Card is Identity Proof only not an Address proof.

Finally, the much-awaited decision has been made by the central government. It authorises the Central Registry of Securitisation Asset Reconstruction and Security Interest of India (CERSAI) to act and to perform the functions of the Central KYC Records Registry (CKYCR), including receiving, storing, safeguarding and retrieving the KYC records in the digital form of a "client". Earlier, the Supreme Court appointed Special Investigation Team on black money had recommended the setup of a CKYC registry agency which will help all financial institutions like banks, fund houses and insurance companies perform KYC through a single window. Banks, payment system providers, system participants and prepaid payment instrument issuers are to "be in readiness to share the KYC data" with the CKYCR.

E-KYC:

e-KYC is electronic KYC. e-KYC is possible for those who have Aadhar numbers. While using e-KYC service, you have to authorize the Unique Identification Authority of India (UIDAI), by explicit consent to release identity / address through biometric authentication to bank branches. The UIDAI transfers the data comprising name, age, gender and photograph of the individual, electronically to the bank. Information provided through e-KYC process is permitted to be treated as an "Official valid document" under PML [Prevention of Money Laundering] act and is a valid process for KYC verification.

1.4. Advances and deposits in a bank

Advances:

Term Deposits

Term deposits refer to such deposits which are placed with the bank for a definite time period, although the customers are free to withdraw their deposit as per their requirements.

Banks may accept term deposits for a minimum period of 7 days (one year in case of NRE deposits) and maximum for a period of 10 years. Banks may accept deposit for periods exceeding 10 years in the event of any orders from the competent court of law.

Banks may accept term deposits for a minimum period of 7 days (one year in case of NRE deposits) and maximum for a period of 10 years. Banks may accept deposit for periods exceeding 10 years in the event of any orders from the competent court of law.

Rate of Interest: Banks may offer differential interest rates on whole sale domestic term deposits of Rs. 15 lakhs and above. For deposits below Rs. 15 lakhs, banks should offer uniform rates for the same maturity.

On domestic term deposits, banks may offer floating rate clearly linked to an anchor rate. Banks to obtain prior approval of its Board or ALM Committee (if powers are delegated to the committee) for fixing rates for various maturities. Unlike Savings Fund Account wherein rate of interest is arbitrated by RBI, in respect of term deposits RBI has vested enough powers to decide upon the rate of interest for deposits of various maturities as above.

Banks are to pay interest at the originally contracted rate on the deposit amount for Sunday/ holiday/non-business working day intervening between the date of expiry of specified term deposit and date of payment of proceeds.

Interest Payable on Deposit Account of Deceased Depositor

According to Reserve Bank of India’s guidelines, individual banks can decide upon this issue. However Indian Bank’s Association (IBA) in its model deposit policy has laid down that:

1. In case of death before maturity, contracted rate be paid till the date of maturity and from the date of maturity till the date of payment, simple interest at the rate applicable (term deposit) on the date of maturity for the period the deposit remained with the bank be paid.
2. In case of death after maturity, the bank shall pay interest at savings rate applicable on the date of maturity, from date of maturity till the date of payment.

Banks cannot accept interest-free deposit, except for deposit at call; for instance money held in current account of the depositor does not bear any interest.

Banks should not discriminate in matter of interest paid on deposit, except for resident senior citizens and other segments as and when notified by the government.

Individual banks have laid down guidelines in respect of renewal of deposit including, premature renewal, premature withdrawal conversion of term deposit into recurring deposit and vice versa. Banks also have put in place guidelines for splitting of deposits into different names as per the instructions of the customer. Banks have also brought in novel schemes of loans/advances against term deposits.

Recurring Deposits

Any individual (singly or jointly) or a minor of 10 years and above in his own name otherwise under guardianship, HUF, a firm, a club, association, educational institution, municipality, Panchayat, society, trust etc. can open the account.

As per the practices followed by the banks by and large, it can be opened for an instalment of Rs.100/- or more or in multiples thereof for a period ranging from 6 months to 120 months in multiples of 3 months. Since this is a de-regulated area, the scheme of one bank need not be the same with that of the other.

Interest: Interest again is deregulated by RBI and as such, rate of interest offered by one bank for the like amount and period may not be the same with that of the other. In normal recurring deposit, instalments are expected to be deposited by the deposit holder on or before the last working day of the month. But in respect of the recurring deposit scheme where there is no stipulation of payment on or before the last working day of the month, the question of fixing any date does not arise. Banks have put in place penalty guidelines in respect of non-payment of instalment in time and waiver procedures have also been laid down by the banks.

Note: As per the prevalent practices relevant to recurring deposit, the deposit shall mature 30 days/ one month after payment of last instalment or on due date whichever is late.

Banks also provide for advances/loan against the recurring deposit, payment of irregular and discontinued recurring deposit account etc. The investor should refer to the related guidelines of the bank where recurring deposit is intended to be opened.

Reserve Bank of India's Model Policy on Bank Deposits

One of the important functions of the bank is to accept deposits from the public for the purpose of lending. In fact, depositors are the major stakeholders of the banking system. The depositors and their interests form the key area of the regulatory framework for banking in India and this has been enshrined in the Banking Regulation Act, 1949. The Reserve Bank of India is empowered to issue directives/advices on interest rates on deposits and other aspects regarding conduct of deposit accounts from time to time. With liberalization in the financial system and deregulation of interest rates, banks are now free to formulate deposit products within the broad guidelines issued by RBI.

Caution Banks also provide for advances/loan against the recurring deposit, payment of irregular and discontinued recurring deposit account etc. The investor should refer to the related guidelines of the bank where recurring deposit is intended to be opened.

Types of Deposit Accounts

While various deposit products offered by the bank are assigned different names. The deposit products can be categorised broadly into the following types. Definition of major deposits schemes are as under:

i. "Demand deposits" means a deposit received by the bank which is withdrawable on demand;
ii. "Savings deposits" means a form of demand deposit which is subject to restrictions as to the number of withdrawals as also the amounts of withdrawals permitted by the Bank during any specified period;
iii. "Term deposit" means a deposit received by the bank for a fixed period withdrawable only after the expiry of the fixed period and include deposits such as Recurring/Double Benefit Deposits/Short Deposits/Fixed Deposits/Monthly Income Certificate/Quarterly Income Certificate etc.;
iv. Notice Deposit means term deposit for specific period, but withdrawable on giving at least one complete banking day's notice;
v. "Current Account" means a form of demand deposit wherefrom withdrawals are allowed any number of times depending upon the balance in the account or up to a particular agreed amount and will also include other deposit accounts which are neither Savings Deposit nor Term Deposit.

Account Opening and Operation of Deposit Accounts

- The bank, before opening any deposit account will carry out due diligence as required under "Know Your Customer" (KYC) guidelines issued by RBI and or such other norms or procedures adopted by the Bank. If the decision to open an account of a prospective depositor requires clearance at a higher level, reasons for any delay in opening of the account will be informed to him and the final decision of the bank will be conveyed at the earliest to him.
- The account opening forms and other material would be provided to the prospective depositor by the Bank. The same will contain details of information to be furnished and documents to be produced for verification and or for record, it is expected of the Bank

pending the account, to explain the procedural formalities and provide necessary clarifications sought by the prospective depositor when he approaches for opening a deposit account.

- Savings Bank Accounts can be opened for eligible person/persons and certain organizations/agencies (as advised by Reserve Bank of India (RBI) from time to time).
- Current Accounts can be opened by individuals/partnership firms/Private and Public Limited Companies/HUFs/Specified Associates/Societies/Trusts, etc.
- Term Deposits Accounts can be opened by individuals/partnership firms/Private and Public Limited Companies/HUFs/Specified Associates/Societies/Trusts, etc.
- The due diligence process, while opening a deposit account will involve satisfying about the identity of the person, verification of address, satisfying about his occupation and source of income. Obtaining introduction of the prospective depositor from a person acceptable to the bank and obtaining recent photograph of the persons opening/operating the account are part of due diligence process.
- In addition to the due diligence requirements, under KYC norms the bank is required by law to obtain Permanent Account Number (PAN) or General Index Register (GIR) Number or alternatively declaration in Form No. 60 or 61 as specified under the Income Tax Act/ Rules.
- Deposit accounts can be opened by an individual in his own name (status: known as account in single name) or by more than one individual in their own names (status: known as Joint Account). Savings Bank Account can also be opened by a minor jointly with natural guardian or with mother as the guardian (Status: known as Minor’s Account). Minors above the age of 10 will also be allowed to open and operate saving bank account independently.
- **Operation of Joint Account**: The Joint Account opened by more than one individual can be operated by single individual or by more than one individual jointly. The mandate for operating the account can be modified with the consent of all account holders. The Savings Bank Account opened by minor jointly with natural guardian/guardian can be operated by natural guardian only.
- At the request of the depositor, the bank will register mandate/power of attorney given by him authorizing another person to operate the account on his behalf.
- The term deposit account holders at the time of placing their deposits can give instructions with regard to closure of deposit account or renewal of deposit for further period on the date of maturity. In absence of such mandate, the Bank will seek instructions from the depositor/s as to the disposal of the deposit by sending intimation before 15 days of the maturity date of term deposit.
- Nomination facility is available on all deposit accounts opened by the individuals. Nomination is also available to a sole proprietary concern account. Nomination can be made in favour of one individual only. Nomination so made can be cancelled or changed by the account holder/s any time. While making nomination, cancellation or change.
- Thereof, it is required to be witnessed by a third party. Nomination can be modified by the consent of account holder/s. Nomination can be made in favour of a minor also.
- The bank has statutory obligation to deduct tax at source if the total interest paid/payable on all term deposits held by a person exceeds the amount specified under the Income Tax

Act. The bank will issue a tax deduction certificate (TDS Certificate) for the amount of tax deducted. The depositor, if entitled to exemption from TDS can submit declaration in the prescribed format at the beginning of every financial year.

- **Minors' Accounts**: The minor can open Savings Bank Account and the same can be operated by the natural guardian or by minor himself/herself, if he/she is above the age of 10 years. The account can also be opened jointly.
- **On attaining majority**, the erstwhile minor should confirm the balance in his/her account and if the account is operated by the natural guardian/guardian, fresh specimen signature of erstwhile minor duly verified by the natural guardian would be obtained and kept on record for all operational purposes.
- **Account of Illiterate/Blind Person**: The bank may at its discretion open deposit accounts other than Current Accounts of illiterate person. The account of such person may be opened provided he/she calls on the bank personally along with a witness who is known to both the depositor and the bank. Normally, no cheque book facility is provided for such Savings Bank Account. At the time of withdrawal/repayment of deposit amount and/or interest, the account holder should affix his/her thumb impression or mark in the presence of the authorized officer who should verify the identity of the person. The bank will explain the need for proper care and safekeeping of the passbook etc. given to the account holder. The bank official shall explain the terms and conditions governing the account to the illiterate/blind person.
- **Secrecy of Customer's Accounts**: The bank shall not disclose details/particulars of the customer's account to a third person or party without the expressed or implied consent from the customer. However, there are some exceptions, viz. disclosure of information under compulsion of law, where there is a duty to public to disclose and where interest of the bank requires disclosure.
- **Premature Withdrawal of Term Deposit**: The bank on request from the depositor, at its discretion may allow withdrawal of term deposit before completion of the period of the deposit agreed upon at the time of placing the deposit. The bank shall declare their penal interest rates policy for premature withdrawal of term deposit. The bank shall make depositors aware of the applicable rate along with the deposit rate.
- **Premature Renewal of Term Deposit**: In case the depositor desires to renew the deposit by seeking premature closure of an existing term deposit account, the bank will permit the renewal at the applicable rate on the date of renewal, provided the deposit is renewed for a period longer than the balance period of the original deposit. While prematurely closing a deposit for the purpose of renewal, interest on the deposit for the period it has remained with the bank will be paid at the rate applicable to the period for which the deposit remained with the bank and not at the contracted rate.
- **Renewal of Overdue Term Deposits**: When a term deposit is renewed on maturity, on renewed deposit interest rate for the period specified by the depositor as applicable on the date of maturity would be applied. If request for renewal is received after the date of maturity, such overdue deposits will be renewed with effect from the date of maturity at interest rate applicable as on the due date, provided such request is received within 14 days from the date of maturity. In respect of overdue deposits renewed after 14 days from the date of maturity, interest for the overdue period will be paid at the rates decided by the bank from time to time.

- **Advances against Deposits**: The bank may consider request of the depositor/s for loan/ overdraft facility against term deposits duly discharged by the depositor/s on execution of necessary security documents. The bank may also consider loan against deposit standing in the name of minor, however, a suitable declaration stating that loan is for the benefit of the minor, is to be furnished by the depositor-applicant.
- **Settlement of Dues in Deceased Deposit Account**:
    - If the depositor has registered nomination with the bank - the balance outstanding in the account of the deceased depositor will be transferred to the account of/paid to the nominee after the bank satisfies about the identity of the nominee, etc.
    - The above procedure will be followed even in respect of a joint account where nomination is registered with the bank.
- In a joint deposit account, when one of the joint account holders dies, the bank is required to make payment jointly to the legal heirs of the deceased person and the surviving depositor(s). However, if the joint account holders had given mandate for disposal of the balance in the account in the forms such as “either or survivor, former/latter or survivor, anyone of survivors or survivor; etc., the payment will be made as per the mandate to avoid delays in production of legal papers by the heirs of the deceased.
- In the absence of nomination and when there are no disputes among the claimants, the bank will pay the amount outstanding in the account of deceased person against joint application and indemnity by all legal heirs or the person mandated by the legal heirs to receive the payment on their behalf without insisting on legal documents up to the limit approved by the bank’s board. This is to ensure that the common depositors are not put hardship on account of delays in completing legal formalities.
- **Interest Payable on Term Deposit in Deceased Account**
    - In the event of death of the depositor before the date of maturity of deposit and amount of the deposit is claimed after the date of maturity, the bank shall pay interest at the contracted rate till the date of maturity. From the date of maturity to the date of payment, the bank shall pay simple interest at the applicable rate obtaining on the date of maturity, for the period for which the deposit remained with the Bank beyond the date of maturity; as per the bank’s policy in this regard.
    - However, in the case of death of the depositor after the date of maturity of the deposit, the bank shall pay interest at savings deposit rate obtaining on the date of maturity from the date of maturity till the date of payment.
- **Safe Deposit Lockers**: This facility is not offered through all bank branches and wherever the facility is offered, allotment of safe deposit vault will be subject to availability and compliance with other terms and conditions attached to the service. Safe deposit lockers may be hired by an individual (being not a minor) singly or jointly with another individual(s), HUFs, firms, limited companies, associates, societies, trusts etc. Nomination facility is available to individual(s) holding the lockers singly or jointly. In respect of lockers held in joint names, up to two nominees can be appointed. Joint locker holders can give mandate for access to the lockers in the event of death of one of the holders on the lines similar to those for deposit accounts. In the absence of nomination or mandate for

disposal of contents of lockers, with a view to avoid hardship to common persons, the bank will release the contents of locker to the legal heirs against indemnity on the lines as applicable to deposit accounts.

- **Redressal of Complaints and Grievances**: Depositors having any complaint/grievance with regard to services rendered by the bank has a right to approach authority (ies) designated by the bank for handling customer complaint/grievances. The details of the internal set up for redressal of complaints/grievances will be displayed in the branch premises. The branch officials shall provide all required information regarding procedure for lodging the complaint. In case the depositor does not get response from the Bank within 60 days from date of complaint or he is not satisfied with the response received from the bank, he has a right to approach Banking Ombudsman appointed by the Reserve Bank of India.

Corporate Banking

Corporate banking represents a wide range of banking and financial services provided to domestic and international operations of large local Corporate and local operations of multinational corporations.

Services include the following:

- Access to commercial banking products, including working capital facilities such as domestic and international trade operations and funding
- Channel financing, and overdrafts
- Letters of guarantee, etc.
- Structured solutions both onshore and offshore
- Term loans (including external commercial borrowings in foreign currency).
- Domestic and international payments
- Support to clients worldwide operations, ensuring a full understanding of the company’s business and financial needs.

Types of loans granted by commercial banks

Secured loan

A secured loan is a loan in which the borrower pledges some asset (e.g. a car or property) as collateral for the loan, which then becomes a secured debt owed to the creditor who gives the loan. The debt is thus secured against the collateral — in the event that the borrower defaults, the creditor takes possession of the asset used as collateral and may sell it to regain some or all of the amount originally lent to the borrower, for example, foreclosure of a home. From the creditor’s perspective this is a category of debt in which a lender has been granted a portion of the bundle of rights to specified property. If the sale of the collateral does not raise enough money to pay off the debt, the creditor can often obtain a deficiency judgment against the borrower for the remaining amount. The opposite of secured debt/loan is unsecured debt, which is not connected to any specific piece of property and instead the creditor may only satisfy the debt against the borrower rather than the borrower’s collateral and the borrower.

Mortgage loan

A mortgage loan is a very common type of debt instrument, used to purchase real estate. Under this arrangement, the money is used to purchase the property. Commercial banks, however, are given security - a lien on the title to the house - until the mortgage is paid off in full. If the borrower defaults on the loan, the bank would have the legal right to repossess the house and sell it, to recover sums owing to it.

In the past, commercial banks have not been greatly interested in real estate loans and have placed only a relatively small percentage of assets in mortgages. As their name implies, such financial institutions secured their earning primarily from commercial and consumer loans and left the major task of home financing to others. However, due to changes in banking laws and policies, commercial banks are increasingly active in home financing.

Changes in banking laws now allow commercial banks to make home mortgage loans on a more liberal basis than ever before. In acquiring mortgages on real estate, these institutions follow two main practices. First, some of the banks maintain active and well-organized departments whose primary function is to compete actively for real estate loans. In areas lacking specialized real estate financial institutions, these banks become the source for residential and farm mortgage loans. Second, the banks acquire mortgages by simply purchasing them from mortgage bankers or dealers.

In addition, dealer service companies, which were originally used to obtain car loans for permanent lenders such as commercial banks, wanted to broaden their activity beyond their local area. In recent years, however, such companies have concentrated on acquiring mobile home loans in volume for both commercial banks and savings and loan associations. Service companies obtain these loans from retail dealers, usually on a non-recourse basis. Almost all bank/service company agreements contain a credit insurance policy that protects the lender if the consumer defaults.

Unsecured Loan

Unsecured Loans are monetary loans that are not secured against the borrower's assets (i.e., no collateral is involved). These may be available from financial institutions under many different guises or marketing packages:

Bank Overdrafts

An overdraft occurs when money is withdrawn from a bank account and the available balance goes below zero. In this situation the account is said to be "overdrawn". If there is a prior agreement with the account provider for an overdraft, and the amount overdrawn is within the authorized overdraft limit, then interest is normally charged at the agreed rate. If the POSITIVE balance exceeds the agreed terms, then additional fees may be charged and higher interest rates may apply.

- Corporate bonds
- Credit card debt
- Credit facilities or lines of credit
- Personal loans

What makes a bank limited liability company?

A corporate bond is a bond issued by a corporation. It is a bond that a corporation issues to raise money in order to expand its business. The term is usually applied to longer-term debt instruments, generally with a maturity date falling at least a year after their issue date. (The term "commercial paper" is sometimes used for instruments with a shorter maturity.) Sometimes, the term "corporate bonds" is used to include all bonds except those issued by governments in their own currencies. Strictly speaking, however, it only applies to those issued by corporations. The bonds of local authorities and supranational organizations do not fit in either category. [Clarification needed] Corporate bonds are often listed on major exchanges (bonds there are called "listed" bonds) and ECNs like Bonds.com and Market Axes, and the coupon (i.e. interest payment) is usually taxable. Sometimes this coupon can be zero with a high redemption value. However, despite being listed on exchanges, the vast majority of trading volume in corporate bonds in most developed markets takes place in decentralized, dealer-based, over-the-counter markets. Some corporate bonds have an embedded call option that allows the issuer to redeem the debt before its maturity date. Other bonds, known as convertible bonds, allow investors to convert the bond into equity. Corporate Credit spreads may alternatively be earned in exchange for default risk through the mechanism of Credit Default Swaps which give an unfunded synthetic exposure to similar risks on the same 'Reference Entities'. However, owing to quite volatile CDS 'basis' the spreads on CDS and the credit spreads on corporate bonds can be significantly different.

Banks will arrange the credit facility in two forms 1. Retail Loan 2. Wholesale Loan

1. **Retail Loans also known as consumer Loans**, is the provision of services by a bank to individual consumers, rather than to companies, corporations or other banks. Services offered include savings and transactional accounts, mortgages, personal loans, debit cards, and credit cards. The term is generally used to distinguish these banking services from investment banking, commercial banking or wholesale banking. It may also be used to refer to a division or department of a bank dealing with retail customers.

Typical products offered by a retail bank include:

- Credit cards
- Traveller's cheques
- Mortgages
- Home equity loans
- Personal loans
- Certificates of deposit/Term deposits

Other Popular Retail Loans are

1) **Home Loan-**Home loan as name suggest is the loan against buying property. Every individual currently have dreams to have their own home. To make affordable best option is home loan. Again there are sub-categories of home loans which are as below.

- Home loan for residents
- Loans for repairs and extension
- Land purchase loan

- Top-up loans
- Loan for Earnest Money Deposits (EMD)
- Reverse Mortgage Loans
- Loan against property

2) **Personal Loan-**It is the loan granted to fulfil the customer expenses which ranges from buying some expensive electronic gadgets to booking your air tickets .Yes people used to use this facility for anything they can. They forget that usually rate of interest on such loans will be higher than other types of loans. But still to have something in advance end up them to borrower of such type of loans. Here we may find two types of loans

Secured Loans-Where customer provides some collateral as a safety against loans.

Unsecured Loans-In such type of loans borrower collateral not required.

3) **Car Loan or Vehicle Loan**-This is usually used to meet your financial requirement when one is planning to have his dream car or bike. It is usually a secured loan where collateral is your vehicle and in case of default lender may recover it by taking back your vehicle. But some lenders offer unsecured loans where your credit score matters more.

4) Education Loan-This is actually a handy tool for parents who not planned well for their kid's higher education. For a detailed view on this visit my earlier post "Know all about Education Loan features".

5) Gold Loan-This was one of the easiest and fastest way of loan when gold rate was at its peak. But currently lot of lenders may not feel it better collateral due to falling in gold price, especially gold loan companies. Recently RBI banned any gold loans against gold ETFs and gold mutual funds. Even though it forms easiest and fastest way of getting loan but better to look for risks involved in it, especially when you are dealing with NBFCs.

6) Loan against Insurance Policies- customer can use his insurance investment as either collateral or take loan from insurer itself if that policy is eligible for loan. Usually loans will be available after 3 years of policy period. Customer will get loan easily on his policy from insurer. But other method to take loan is to pledge your policy document with banks and take loan on that. LIC will offer loan on policy with the interest rate of 10%, which I think competitive pricing compare to other type of loans.

7) Loan against Bank FDs-This is one form of loan where customer's collateral is his bank FD itself. Suppose a customer have bank FD of around Rs.10,00,000 then he/she usually eligible to get loan up to Rs.8,00,000. But interest rates will 1-2% higher than your FD rate. But still this form of loan is also fastest and best way.

8) Loan against Shares or Mutual Funds-Few lenders offer loan against customer investment value of shares or mutual funds. But customer will not get more value from this. Reason is, both the investments (if mutual fund is of equity oriented) then fluctuation in values will be high. Hence to protect their loan amount usually lenders offer fewer loans.

Wholesale Loans: Wholesale banking is the provision of services by banks to organizations such as Mortgage Brokers, large corporate clients, mid-sized companies, real estate developers and investors, international trade finance businesses, institutional customers (such as pension funds and government entities/agencies), and services offered to other banks or other financial institutions.

Wholesale finance refers to financial services conducted between financial services companies and institutions such as banks, insurers, fund managers, and stockbrokers.

Modern wholesale banks engage in:

- Finance wholesaling
- Underwriting
- Market making
- Consultancy
- Mergers and acquisitions
- Fund management

Differences between Retail and Wholesale banking:

Those days are gone when banking referred to only one thing that is a place where savers can deposit money and borrower take loan when they are in need of funds, however nowadays banking has changed completely and it encompasses many things. Retail and wholesale banking are two of them; let's look at some of the differences between retail and wholesale banking

1. Retail banking refers to that banking which targets individuals and the main focus of such banks is retail customer whereas wholesale banking refers to that banking which targets corporate or big customers and their main focus is providing services to corporate clients.
2. Ticket size of loans given in retail banking is low and due to it impact of NPA will be less pronounced due to diversification as compared to wholesale banking where ticket size of loan is very high and due to it impact of NPA is more pronounced.
3. Loans such as car, housing, educational, personal loans are some of the examples of loans given in retail banking whereas loans such as loan for setting industry, machinery advance, export credit are some of the examples of loans given in wholesale banking.
4. Monitoring and recovery if the loan turn out to be NPA in retail banking is more difficult because customer base is wide whereas in case of wholesale banking due to low customer base it is easy to monitor as well recover the loan given to customers.
5. Cost of deposit is low in retail banking because retail customers do not have the bargaining power due to less deposit with them whereas in case of corporate customers banks have to offer them high interest rates in order to attract funds from them.
6. Retail banking requires large network of branches in order to cater to large customer base and hence it results in high operational costs while in case of wholesale banking small number of branches is sufficient to cater to corporate clients.

The Banks can arrange the credit facility mainly in two ways in which generally calls as Assets for the banks, because they are the earning sources for the banks. One is in the form of Retail Loans and another is in the form of Wholesale or Merchant Loan. In general Retail Loans are aimed for natural and regular income generating households and certain category of people where credit amount not exceeds more than Rs 1 crore. Where Whole sale loans are aimed for Industries and Institutional Persons and the credit facility providing by the banks depends on the business size.

1.5. New dimensions and Products

E-Banking: Electronic Banking in simple terms means, it does not involve any physical exchange of money, but it's all done electronically, from one account to another, using the Internet. Internet banking is just like normal banking, with one big exception. Customer doesn't have to go to the bank for transactions. Instead, customer can access his account any time and from any part of the world, and do so when he has the time, and not when the bank is open. For busy executives, students, and homemakers, e-banking is a virtual blessing.

Electronic Banking also known as Internet Banking is the latest in the series of technological wonders of the recent past. ATMs, Tele-Banking, Internet Banking, Credit Cards and Debit Cards have emerged as effective delivery channels for traditional banking products. Banks know that the Internet opens up new horizons for them and moves them from local to global frontiers.

- **Online Banking:** Online banking, also known as internet banking, e-banking or virtual banking, is an electronic payment system that enables customers of a bank or other financial institution to conduct a range of financial transactions through the financial institution's website. The online banking system will typically connect to or be part of the core banking system operated by a bank and is in contrast to branch banking which was the traditional way customers accessed banking services.
- **Tab Banking:** Tab Banking' which offers the convenience of opening a bank account at customer home or office. Powered with an advanced application on tablets, customer can now enjoy a faster and smoother account opening experience. With Tab Banking, avoid the hassle of arranging paper work like physical photograph and photocopies of KYC documents. Bank's Tab Banking officer will come to a place of prosperous customer convenience, click photograph and scan the necessary documents required to open a Bank account with the help of a tablet and account will be activated within a day.
- **Virtual Banking:** A financial institution that handles all transactions via the Web, e-mail, mobile check deposit and ATM machines. By not having the overhead of physical branches, people expect a virtual bank to offer higher interest rates on their accounts. All transactions in a virtual bank are handled entirely online, whereas "online banking" is an Internet-based option offered by regular banks.
- **Mobile Banking:** Mobile banking refers to the use of a smart phone or other cellular device to perform online banking tasks while away from your home computer, such as monitoring account balances, transferring funds between accounts, bill payment and locating an ATM.

Digital Banking: Digital Banking is the application of technology to ensure seamless end-to-end (STP in the 'old' jargon) processing of banking transactions/operations; initiated by the client, ensuring maximum utility; to the client in terms of availability, usefulness and cost; to the bank in terms of reduced operating costs, zero errors and enhanced services.

Advantages

- It's generally secure.
- It has twenty-four-hour access.
- Customer can access his account from virtually anywhere.

- Conducting business online is generally faster than going to the bank.
- Many features and services are typically available online.

For example, with just a few clicks any one can apply for loans, check the progress of investments, review interest rates and gather other important information that may be spread out over several different brochures in the local bank.

Disadvantages

- Yes, online banking is generally secure, but it certainly isn't always secure.
- Some online banks are more stable than others. Not all online setups are an extension of a brick-and-mortar bank. Some operate completely in cyberspace, without the benefit of an branch that can actually visit if need be.
- Before using a banking site that aren't familiar with, check to make sure that their deposits are DICGC insured. If not, customer could possibly lose all of his deposits if the bank goes under, or its major shareholders decide to take an extended vacation.
- Not all online transactions are immediate. Online banking is subject to the same business-day parameters as traditional banking. Therefore, printing out and keeping receipts is still very important, even when banking online.

Direct Banking/ Face to face: A direct distribution channel is organized and managed by the bank itself in approaching the customer.

Indirect Banking: An indirect distribution channel relies on intermediaries to perform most or all distribution functions, otherwise known as wholesale distribution. Those with indirect distribution channels have to set up relationships with third-party selling systems.

Chain Banking: Chain banking is a form of banking when a small group of individuals control three or more banks which are independently chartered. Individuals secure enough stocks to get the controlling interest in the banking corporations involved. The management can also be established via a board of directors that can effectively create a network and undertake supervision of banking activities. Chain banking systems took shape in USA around 1925 when 33 chains were co-existing having ownership of 933 banks. The purpose was to maximise profit and goodwill in the market. The banks which entered into chains within a community had little scope of competition from other banks operating in the same area. The investors ensured that each bank in the chain catered to the interests of different segments in the market so that there was no overlapping of interests and the returns were not compromised. There is generally no holding company to control the interests of banks. Thus, the underlying principles of chain banking are:

- A small group of persons own and control a number of independent banks
- Each bank carries its operations independently without any external interference by any holding company.
- Every member of the chain retains its independent identity.

Social Banking: "Social Banking "describes the provision of banking and financial services that consequently pursue, as their main objective, a positive contribution to the potential of all human beings to develop, today and in the future.

In Social Banking, the focus is on satisfying existing needs in the real economy and the society whilst simultaneously taking into account their social, cultural, ecological and economic sustainability. Furthering the common good by generating multiple returns with respect to these aspects is at its core. Generating a monetary profit is not an end but a frequent prerequisite to guaranteeing the necessary flexibility for pursuing its objective in a continuously changing environment.

Branch Banking: In Branch Banking, the Branches in India are set up under Section 23 of Banking Regulations Act, 1949. A branch should cater to all banking services and include a specialised branch, a satellite office, an extension counter, an ATM, administrative office, service branch and a credit card centre for the purpose of branch authorisation policy. It helps in better management, more inclusion and risk diversification.

Unit Banking: Unit banking 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 local community. Unit system of banking originated in the United States. In Unit system, the size of banks is small as compared to branch banking. Due to small scale of operations and quick decisions, the work is more efficient. These banks are involved in developmental works in the areas of operations. The management enjoys more autonomy and thus more discretionary powers. However, due to single units, the risk is not distributed or diversified. It may however encourage outside local influences.

Corresponding Banking: A correspondent bank is a financial institution that provides services on behalf of another, equal or unequal, financial institution. It can facilitate wire transfers, conduct business transactions, accept deposits and gather documents on behalf of another financial institution. Correspondent banks are most likely to be used by domestic banks to service transactions that either originate or are completed in foreign countries, acting as a domestic bank's agent abroad.

Generally, the reasons domestic banks employ correspondent banks include limited access to foreign financial markets and the inability to service client accounts without opening branches abroad. Correspondent banks can act as intermediaries between banks in different countries or as an agent to process local transactions for clients when they are travelling abroad. At the local level, correspondent banks can accept deposits, process documentation and serve as transfer agents for funds. The capability to execute these services relieves domestic banks of the need to establish a physical presence in foreign countries.

Note: The accounts held between correspondent banks and the banks to which they are providing services are referred to as Nostro and Vostro accounts. An account held by one bank for another is referred to by the holding bank as a Nostro account. The same account is referred as a Vostro account by the counterparty bank. Generally, both banks in a correspondent relationship hold accounts for one another for the purpose of tracking debits and credits between the parties.

Relationship Banking: Relationship banking is a strategy used by banks to enhance their profitability. They accomplish this by cross-selling financial products and services to strengthen their relationships with customers and increase customer loyalty. Relationship banking involves offering customers a broad array of financial products and services that go beyond simple checking and savings accounts.

In addition to these two basic products, relationship-banking products may include certificates of deposit, safe deposit boxes, insurance, investments, credit cards, loans and business services (e.g., credit card processing). They may also include specialized financial products designed for specific demographics, such as students, seniors or the wealthy.

Narrow Banking: Narrow Banking means Narrow in the sense of engagement of funds and not in activity. So, simply, Narrow Banking involves mobilizing the large part of the deposits in Risk Free assets such as Government Securities.

Consider the following statements:

1. In Narrow Banking, Banks just accept deposits and provide loans.
2. In Narrow Banking, there is rarely Asset Liability Mismatch.

Which among the above statements is / are correct? In the above question, only statement 2 is correct. The Narrow Banking is very much an antonym to the Universal Banking. In Narrow Banking, the Bank places its funds under the risk free assets and the maturity of the liabilities match the assets and there is No possibility of the Asset Liability Mismatch.

- Banks in India partially implement the Narrow banking.
- The RBI prescribes a 25% SLR Statutory Liquidity Ratio, but Banks invest much more than that in Government securities which provides them a low return. The Government securities have a 0% risk weightage and the Government approved Securities have a risk weightage of 2.5% , compared to the loan assets which have around 50-75%.
- Narrow Banking, in Narrow sense helps the Banks to reduce the Non Performing Assets (NPA) as the engagement brings them some returns also.

Narrow Banking and Tarapore Committee: The Tarapore Committee had recommended that to bring down the NPAs, the incremental sources of the banks (called narrow banks) should be restricted only to investments in Government Securities. Thus Tarapore Committee is best known for giving the Concept of Narrow Banking as a solution to the problem of Non Performing Assets.

Investment Banking: Investment banking is a specific division of banking related to the creation of capital for other companies, governments and other entities. Investment banks underwrite new debt and equity securities for all types of corporations, aid in the sale of securities, and help to facilitate mergers and acquisitions, reorganizations and broker trades for both institutions and private investors. Investment banks also provide guidance to issuers regarding the issue and placement of stock.

Investment banks employ investment bankers who help corporations, governments and other groups plan and manage large projects, saving their client time and money by identifying risks associated with the project before the client moves forward. In theory, investment bankers are experts in their field who have their finger on the pulse of the current investing climate, so businesses and institutions turn to investment banks for advice on how best to plan their development, as investment bankers can tailor their recommendations to the present state of economic affairs.

Retail Banking: Retail banking, also known as consumer banking, is the provision of services by a bank to individual consumers, rather than to companies, corporations or other banks. Services offered include savings and transactional accounts, mortgages, personal loans, debit cards, and credit cards.

The term is generally used to distinguish these banking services from investment banking, commercial banking or wholesale banking. It may also be used to refer to a division or department of a bank dealing with retail customers.

Wholesale Banking: Wholesale banking is the provision of services by banks to organizations such as Mortgage Brokers, large corporate clients, mid-sized companies, real estate developers and investors, international trade finance businesses, institutional customers (such as pension funds and government entities/agencies), and services offered to other banks or other financial institutions.

Rural Banking: Rural banking in India started since the establishment of banking sector in India. Rural Banks in those days mainly focused upon the agro sector. Today, commercial banks and Regional rural banks in India are penetrating every corner of the country are extending a helping hand in the growth process of the rural sector in the country.

Merchant Banking: A merchant bank is a company that deals mostly in international finance, business loans for companies and underwriting. These banks are experts in international trade, which makes them specialists in dealing with multinational corporations. A merchant bank may perform some of the same services as an investment bank, but it does not provide regular banking services to the general public.

One role of a merchant bank is to provide financing to large corporations that do business overseas. Assume, for example, that XYZ Company is based in the United States and decides to purchase a supplier that is based in Germany.

Example: A merchant bank can provide the funds to make the purchase using a letter of credit (LOC). The sellers in Germany receive an LOC issued by the merchant bank as payment for the purchase. Merchant banks can also help the purchaser work through the legal and regulatory issues required to do business in Germany.

Green Banking: Green Banking, as defined by Institute for Development and Research Technology, is an umbrella term referring to practices and guidelines that make banks sustainable in economic, environment, and social dimensions. It aims to make banking processes and the use of IT and physical infrastructure as efficient and effective as possible, with zero or minimal impact on the environment.

Considering the nature of banking processes and infrastructures, IDRBT offers guidelines for greening banking in two levels.

- Making day-to-day business operations, banking products and services greener by following simple practices and making them environmentally friendly.
- Making IT infrastructure (including data centre) and physical infrastructure (including buildings) greener and taking initiatives so that a bank could itself generate electricity for its own consumption.

Group Banking: A plan offered by banks that generally provides incentives for groups, such as employees at a company, if the group establishes a banking relationship with the institution. Potential incentives for group banking can include lower interest rates, lower fees and discounts.

Some other benefits of group-banking plans include a single point of contact for the group, and a bank contact which is generally more knowledgeable with the group's plan and needs. Also, many banks may offer group seminars.

Mixed Banking: Mixed banking is an approach where banks undertake both commercial and industrial banking and is a popular banking model in countries like Germany and Japan. German banks present a typical case of banking where they undertake multiple functions and are thus referred to as ‘Universal Banks’. The development of mixed banking model in Germany is based on the fact that there was no proper financial institution in Germany which could support the development and proliferation of its industry.

Trade and commerce were also in nascent stages. Thus, both the governments and banks felt the need to provide sufficient funds for long-term was essential for speedy industrialisation. Hence, instead of just short-term lending for trade and commerce, the banks started to advance long-term loans and subscribed to the shares or debentures of the young companies. This also gave a requisite push to the stock exchange due to the marketability of shares of these joint stock companies. In India, the recommendations of the Shroff Committee in 1954 suggested that Indian banks too can support industrial finance.

Key Features of Mixed Banking Mixed banking basically stands for a combination of two pure banking models like commercial banking and investment banking in different proportions. Although it was banned in US for a large part of 20th Century under Glass-Steagall Act, due to an abstract conflict of interest with traditional modes of banking, the system remained in place in rest of the world. Further on, relaxing of restrictions on traditional banking, investment banking, asset management, insurance etc. gave the desired boost to universal banking models. The Basel Committee on Banking Supervision classified 20 out of 28 G-SIB (Global Systemically Important Banks) as Universal Banks.

Thus, this system provides a one-roof solution to industries for short-term finance to meet needs like purchase of raw-materials, wages etc. and also for long-term finance for purchase of plant and machinery. It helps commercial banks to raise enough funds to provide substantial aid to various firms. The banks gauge the soundness of industrial units by security evaluation. They guide and advice the industrial units on covering their financial needs by selling of shares, stocks and debentures. This helps in stimulating capital formation in the country and thereby promotes industrialisation. On the other hand, it reduces the liquidity at the hands of banks as a major part of their funds are parked in long-term finance. Such banks are not able to withstand sharp economic downturns especially when the securities of companies suffer a major loss in value. Many German banks suffered a major fall in 1929 Great Depression as many industries to which they had lent experienced a fall in prices and profits. The lesser amount of liquid money at disposal further may come in conflict with the pure structure of banking.

Universal Banking: Universal banking is a banking system in which banks provide a wide variety of financial services, including commercial and investment services. Universal banking is common in some European countries, including Switzerland. In the United States, however, banks are required to separate their commercial and investment banking services. Proponents of universal banking argue that it helps banks better diversify risk. Detractors think dividing up banks' operations is a less risky strategy.

Universal banks may offer credit, loans, deposits, asset management, investment advisory, payment processing, securities transactions, underwriting and financial analysis. While a universal banking system allows banks to offer a multitude of services, it does not require them to do so. Banks in a universal system may still choose to specialize in a subset of banking services.

Personal Banking: Personal banking is a type of banking service and product line offered by banks to retail customers, that is consumers rather than businesses, intermediaries and institutions. Banks worldwide offer personal banking products that typically include savings and transaction facilities such as a bank transaction account, debit cards/EFT, an interest bearing floating account (savings account) and a fixed interest deposit account for a specific agreed period (certificates of deposit / term deposit) which can vary according to the bank. In addition it also includes debt facilities such as loans, mortgages and credit cards.

Tele Banking: Telephone banking is a service provided by a bank or other financial institution that enables customers to perform a range of financial transactions over the telephone, without the need to visit a bank branch or automated teller machine. Telephone banking times are usually longer than branch opening times, and some financial institutions offer the service on a 24-hour basis. Most financial institutions have restrictions on which accounts may be accessed through telephone banking, as well as a limit on the amount that can be transacted.

Specialised Banking: A specialised banking means the bank or its branch mainly focuses on one particular religion, customer, service in banking operations. Some of the specialised banks in India are as follows:

1. **Beggars Banks:** A group of beggars in this Bihar town has opened their own bank, which they run and manage to provide financial security in times of crisis. Dozens of beggars, who have been depending for their survival on alms from hundreds of Hindu devotees at the gate of 'Maa Manglagauri Mandir' (temple) in Gaya town for years, have started the bank. The beggars call it Mangala Bank.
2. **Women Banks:** Bharateeya Mahila Bank is an Indian financial services banking company based in Mumbai, India. Former Indian Prime Minister Manmohan Singh inaugurated the system on 19 November 2013 on the occasion of the 96th birth anniversary of former Indian Prime Minister Indira Gandhi. Although initially reported as a bank exclusively for women, the bank allows deposits to flow from everyone, but lending will be predominantly for women. India is the third country in the world to have a bank especially for women, after Pakistan and Tanzania.
   Note: Now this bank merges with SBI
3. **Islamic Development/Sharia Bank:** The Reserve Bank of India (RBI) has proposed opening of “Islamic window” in conventional banks for “gradual” introduction of Sharia-compliant or interest-free banking in the country. Both the Centre and RBI are exploring the possibility of introduction of Islamic banking for long to ensure financial inclusion of those sections of the society that remain excluded due to religious reasons.
   Saudi Arabia’s Islamic Development Bank (IDB) has decided to open its first branch in India at Ahmedabad, Gujarat. In this regard, IDB and its private sector arm, Islamic Corporation for the Development of the Private Sector (ICD), already have met with top officials of the Reserve Bank of India (RBI), EXIM Bank and India’s other nationalized banks. This

announcement comes as part of MoU signed between IDB and India's EXIM Bank during Prime Minister Narendra Modi visit to United Arab Emirates (UAE) in April 2016. As part of the MoU a US 100 million dollars line-of-credit (LoC) was to be given to IDB's member countries to facilitate exports.

a. Besides, IDB also has decided to provide Gujarat state 30 medical vans as part of its social sector initiatives. Islamic Development Bank (IDB) is a multilateral development financing institution based in Jeddah, Saudi Arabia. Presently, it has 56 Islamic countries as its members. It was founded in 1973 by the Finance Ministers at the first Organisation of the Islamic Conference (now Organisation of Islamic Cooperation). IDB's objective is to foster the economic development and social progress of member countries as well as the Muslim community in accordance with principles of Islamic (Shariah) law.

4. **Bad Banks:** A bad bank is a corporate structure to isolate illiquid and high risk assets held by a bank or a financial organisation, or perhaps a group of banks or financial organisations. A bank may accumulate a large portfolio of debts or other financial instruments which unexpectedly increase in risk, making it difficult for the bank to raise capital, for example through sales of bonds. In these circumstances, the bank may wish to segregate its "good" assets from its "bad" assets through the creation of a bad bank. The goal of the segregation is to allow investors to assess the bank's financial health with greater certainty. A bad bank might be established by one bank or financial institution as part of a strategy to deal with a difficult financial situation, or by government or some other official institution as part of an official response to financial problems across a number of institutions in the financial sector.

5. **Industrial development banks :** The banks like IDBI,NABARD,SIDBI,NHB,MUDRA etc

1.5.2. Products of Banks

Types of Electronic Payment services providing by the Indian Banks:

Payment and settlement systems in India are regulated by the Payment and Settlement Systems Act, 2007 (PSS Act), legislated in December 2007. The Reserve Bank of India continually strives towards ensuring the smooth progress of the payments system. In India it is the BPSS (Board for Regulation and Supervision of Payment and Settlement Systems) which is in charge of regulating these systems.

India has multiple payments and settlement systems. RBI Still continues to evolve new payment methods and slowly revamping the payments and settlement capability in India.

India supports a variety of electronic payments and settlement system, both Gross as well as Net settlement systems.

The Gross systems is Real Time Gross Settlement (RTGS)

The Net settlement systems are:

- ECS - Credit
- ECS - debit

- Card based Payment services (CBPS) Credit cards and Debit cards
- National Electronic Fund Transfer (NEFT)
- Immediate Payment Service

Other methods:

- Aaadhar Enabled Payment system (AEPS)
- Bharath Bill Payment services (BBPS)

Electronic funds transfer (EFT): It is the electronic transfer of money from one bank account to another, either within a single financial institution or across multiple institutions, via computer-based systems, without the direct intervention of bank staff. EFT's are known by a number of names. In the United States, they may be referred to as electronic checks or e-checks.

The term covers a number of different payment systems, for example:

- cardholder-initiated transactions, using a payment card such as a credit or debit card
- direct deposit payment initiated by the payer
- direct debit payments for which a business debits the consumer's bank accounts for payment for goods or services
- wire transfer via an international banking network such as SWIFT
- electronic bill payment in online banking, which may be delivered by EFT or paper check
- Transactions involving stored value of electronic money, possibly in a private currency.

National Electronic Fund Transfer (NEFT)

Meaning – It is way in which Customer can transfer fund from any bank account to any other bank account holder in India. NEFT is based on batch processing system.

- **Minimum amount –** Rs. 1
- **Maximum amount –** There is no upper ceiling for transferring money through NEFT, but generally RTGS is used for transfer of Rs 2,00,000 or above
- **Time limit –** The transactions are processed in hourly batches. There are twelve settlements from 8 A.M. to 7 P.M. on the weekdays (Monday – Friday) and six settlements from 8 A.M. to 1 P.M. on Saturday. The maximum time consumed is 2 hours from the submitting of the transaction in a batch.
- **Availability** – NEFT is not available on the bank holidays, RBI holiday and Sunday.

Note - For transferring funds to Nepal, the limit is of Rs. 50, 000.

Real Time Gross Settlement (RTGS)

- **Meaning** – It is way in which Customer can transfer fund from any bank account to any other bank account holder in India in real time.
- **Minimum amount –** Rs 2,00,000

- **Maximum amount –** No limit
- **Time limit –** The transactions are processed on order basis i.e. Real time. The RTGS service is available from 8 A.M to 8 P.M. on the weekdays (Monday – Friday) and from 8 A.M. to 3:30 P.M. on Saturday. The transfer is instant but the bank is allowed to take up to 2 hours for crediting the amount to the depositor account.
- Availability – RTGS is not available on the bank holidays, RBI holiday and Sunday.

Immediate payment services or Inter Mobile Payment Service (IMPS) :

Yet another online money transfer option, IMPS is operated by the National Payments Corporation of India (NPCI) and involves almost all the major/minor banks of the country as participating members. Unlike NEFT or RTGS, IMPS transactions can be affected 24×7 and conveniently through your mobile phone, ATM or the internet. Naturally, this system is fast, safe and available to an exponentially larger demographic of people. A good mobile internet connection, proper credentials from the bank and a recipient's account to are all you require for an IMPS transaction.

- **Meaning** – It is way in which customer can transfer fund from any bank account to any other bank account holder in India anytime.
- **Minimum amount** – Rs 1
- **Maximum amount** – Banks are allowed to set their own limit for IMPS.
- **Time limit** – It is real time. The depositor account is credited in less than 1 minute from the submission of transaction.
- **Availability** – IMPS can be done 24X7 even on bank holidays, RBI holiday and Sunday

Electronic Clearing Service (ECS): ECS is an electronic mode of payment / receipt for transactions that are repetitive and periodic in nature. ECS is used by institutions for making bulk payment of amounts towards distribution of dividend, interest, salary, pension, etc., or for bulk collection of amounts towards telephone / electricity / water dues, cess / tax collections, loan instalment repayments, periodic investments in mutual funds, insurance premium etc. Essentially, ECS facilitates bulk transfer of monies from one bank account to many bank accounts or vice versa. ECS includes transactions processed under National Automated Clearing House (NACH) operated by National Payments Corporation of India (NPCI).

Primarily, there are two variants of ECS – ECS Credit and ECS Debit.

ECS Credit is used by an institution for affording credit to a large number of beneficiaries (for instance, employees, investors etc.) having accounts with bank branches at various locations within the jurisdiction of a ECS Centre by raising a single debit to the bank account of the user institution. ECS Credit enables payment of amounts towards distribution of dividend, interest, salary, pension, etc., of the user institution.

ECS Debit is used by an institution for raising debits to a large number of accounts (for instance, consumers of utility services, borrowers, investors in mutual funds etc.) maintained with bank branches at various locations within the jurisdiction of an ECS Centre for single credit to the bank account of the user institution. ECS Debit is useful for payment of telephone / electricity / water bills, cess / tax collections, loan instalment repayments, periodic investments in mutual funds, insurance premium etc., that are periodic or repetitive in nature and payable to the user institution by large number of customers etc.

Based on the geographical location of branches covered, there are three broad categories of ECS Schemes – Local ECS, Regional ECS and National ECS. These schemes are either operated by RBI or by the designated commercial banks. NACH is also one of the forms of ECS system operated by NPCI.

Card Based Payment Services: A payment service provider (PSP) offers shops online services for accepting electronic payments by a variety of payment methods including credit card, bank-based payments such as direct debit, bank transfer, and real-time bank transfer based on online banking. Typically, they use software as a service model and form a single payment gateway for their clients (merchants) to multiple payment methods.

Typically, a PSP can connect to multiple acquiring banks, card, and payment networks. In many cases, the PSP will fully manage these technical connections, relationships with the external network, and bank accounts. This makes the merchant less dependent on financial institutions and free from the task of establishing these connections directly, especially when operating internationally. Furthermore, by negotiating bulk deals they can often offer cheaper fees.

Furthermore, a full-service PSP can offer risk management services for card and bank based payments, transaction payment matching, reporting, fund remittance and fraud protection in addition to multi-currency functionality and services. Some PSPs provide services to process other next generation methods (payment systems) including cash payments, wallets, prepaid cards or vouchers, and even paper or e-check processing.

A PSP is thus a much broader term than a payment gateway which is how the payment card industry refers to them.

PSP fees are typically levied in one of two ways: as a percentage of each transaction or a fixed cost per transaction.

Aadhar Enabled Payment Services:

In order to further speed track Financial Inclusion in the country, Two Working Group were constituted by RBI on Micro ATM standards and Central Infrastructure & Connectivity for Aadhaar based financial inclusion transactions with members representing RBI, Unique Identification Authority of India, NPCI, Institute for Development and Research in Banking Technology and some special invitees representing banks and research institutions.

The working group on Micro ATM standards & Central Infrastructure & Connectivity has submitted its report to RBI. As a part of the working group it was proposed to conduct a Lab level Proof of concept (PoC), integrating the authentication & encryption standards of UIDAI, to test the efficacy of Micro ATM standards and transactions using Aadhaar before they are put to actual use. The PoC was successfully demonstrated at various venues.

AEPS is a bank led model which allows online interoperable financial inclusion transaction at PoS (Micro ATM) through the Business correspondent of any bank using the Aadhaar authentication.

The four Aadhaar enabled basic types of banking transactions are as follows:-

- Balance Enquiry
- Cash Withdrawal
- Cash Deposit
- Aadhaar to Aadhaar Funds Transfer

The only inputs required for a customer to do a transaction under this scenario are:-

- IIN (Identifying the Bank to which the customer is associated)
- Aadhaar Number
- Fingerprint captured during their enrolment

Bharat Bill Payment System (BBPS) is an integrated bill payment system in India offering interoperable and accessible bill payment service to customers through a network of agents, enabling multiple payment modes, and providing instant confirmation of payment.

National Payments Corporation of India (NPCI) will function as the authorised Bharat Bill Payment Central Unit (BBPCU), which will be responsible for setting business standards, rules and procedures for technical and business requirements for all the participants. NPCI, as the BBPCU, will also undertake clearing and settlement activities related to transactions routed through BBPS. Existing bill aggregators and banks are envisaged to work as Operating Units to provide an interoperable bill payment system irrespective of which unit has on-boarded a particular biller. Payments may be made through the BBPS using cash, transfer cheques, and electronic modes.

Indian Financial System Code (IFSC) is an alphanumeric code that facilitates electronic funds transfer in India. A code uniquely identifies each bank branch participating in the two main Payment and settlement systems in India: the Real Time Gross Settlement (RTGS) and the National Electronic Fund Transfer (NEFT) systems. The IFSC is an 11-character code with the first four alphabetic characters representing the bank name, and the last six characters (usually numeric, but can be alphabetic) representing the branch. The fifth character is 0 (zero) and reserved for future use. Bank IFS Code is used by the NEFT & RTGS systems to route the messages to the destination banks/branches. The format of the IFS Code is shown below.

1	**2**	**3**	**4**	**5**	**6**	**7**	**8**	**9**	**10**	**11**
Bank Code				0	Branch Code					

UTR Number: UTR is Unique Transaction Reference number that is generated in RTGS system for uniquely identifying any transaction. The format of UTR is predefined and is generated by the bank initiating the transaction.

The format is: XXXXAYYDDD999999
Where XXXX is the bank code. For eg. SBI's bank code is SBIN.
A is the system identifier. The possible values are 'P' - for transactions generated in RTGS interface/application or 'H' - for transactions generated in Bank's host system, YY is two digits year 10 for 2010. DDD is Julian date. 032 for Feb 1. 999999 is 6 digit sequence number.

1.6. Types of Negotiable Instruments and Cheques

A negotiable instrument is a document guaranteeing the payment of a specific amount of money, either on demand, or at a set time, with the payer named on the document. More specifically, it is a document contemplated by or consisting of a contract, which promises the payment of money without condition, which may be paid either on demand or at a future date. The term can have different meanings, depending on what law is being applied and what country it is used in and what context it is used in.

Examples of negotiable instruments include promissory notes, bills of exchange, banknotes, demand draft and cheques.

Because money is promised to be paid, the instrument itself can be used by the holder in due course as a store of value. The instrument may be transferred to a third party; it is the holder of the instrument who will ultimately get paid by the payer on the instrument. Transfers can happen at less than the face value of the instrument and this is known as discounting; e.g., this may happen if there is doubt about the payer's ability to pay. The Negotiable Instruments Act, 1881 in India

Some of the important definitions of the Act are:

Section 4 - Promissory note

A "promissory note" is an instrument in writing (not being a bank-note or a currency-note) containing an unconditional undertaking, signed by the maker, to pay a certain sum of money only to, or to the order of, a certain person, or to the bearer of the instrument.

Section 5 - Bill of exchange

A "bill of exchange" is an instrument in writing containing an unconditional order, signed by the maker, directing a certain person to pay a certain sum of money only to, or to the order of, a certain person or to the bearer of the instrument.

A promise or order to pay is not "conditional", within the meaning of this section and section 4, by reason of the time for payment of the amount or any instalment thereof being expressed to be on the lapse of a certain period after the occurrence of a specified event which, according to the ordinary expectation of mankind, is certain to happen, although the time of its happening may be uncertain.

The sum payable may be "certain", within the meaning of this section and section 4, although it includes future interest or is payable at an indicated rate of exchange, or is according to the course of exchange, and although the instrument provides that, on default of payment of an instalment, the balance unpaid shall become due.

The person to whom it is clear that the direction is given or that payment is to be made may be a "certain person", within the meaning of this section and section 4, although he is mis-named or designated by description only.

Section 6 - Cheque

A cheque is bill of exchange drawn on a specified banker and not expressed to be payable otherwise than on demand and it includes the electronic image of a truncated cheque and a cheque in the electronic form.

Explanation: I. - For the purposes of this section, the expressions-

a. a cheque in the electronic form means a cheque which contains the exact mirror image of a paper cheque, and is generated, written and signed in a secure system ensuring the minimum safety standards with the use of digital signature (with or without biometrics signature) and asymmetric crypto system;
b. a truncated cheque means a cheque which is truncated during the course of a clearing cycle, either by the clearing house or by the bank whether paying or receiving payment, immediately on generation of an electronic image for transmission, substituting the further physical movement of the cheque in writing.

Explanation II - For the purposes of this section, the expression clearing house means the clearing house managed by the Reserve Bank of India or a clearing house recognised as such by the Reserve Bank of India.

Section 13 - Negotiable Instruments

1. Negotiable instrument. A Negotiable Instrument means a promissory note, bill of exchange or cheque payable either to order or to bearer.

Explanation (i).-A promissory note, bill of exchange or cheque is payable to order which is expressed to be so payable or which is expressed to be payable to a particular person, and does not contain words prohibiting transfer or indicating an intention that it shall not be transferable.

Explanation (ii).-A promissory note, bill of exchange or cheque is payable to bearer which is expressed to be so payable or on which the only or last endorsement is an endorsement in blank.

Explanation (iii).-Where a promissory note, bill of exchange or cheque, either originally or by endorsement, is expressed to be payable to the order of a specified person, and not to him or his order, it is nevertheless payable to him or his order at his option.

2. A negotiable instrument may be made payable to two or more payees jointly, or it may be made payable in the alternative to one of two, or one or -some of several payees.

Section 123 - Cheque Crossed Generally

Where a cheque bears across its face an addition of the words and company or any abbreviation thereof, between two parallel transverse lines, or of two parallel transverse lines simply, either with or without the words, not negotiable, that addition shall be deemed a crossing, and the cheque shall be deemed to be crossed generally.

Section 124 - Cheque crossed specially

Where a cheque bears across its face an addition of the name of a banker, either with or without the words not negotiable, that addition shall be deemed a crossing, and the cheque shall be deemed to be crossed specially, and to be crossed to that banker.

Section 126 Cheque crossed specially

Where a cheque is crossed generally, the banker, on whom it is drawn, shall not pay it otherwise than to a banker.

Payment of cheque crossed specially. - Where a cheque is crossed specially, the banker on whom it is drawn shall not pay it otherwise than to the banker to whom it is crossed, or his agent, for collection.

Section 130 Cheque bearing Not Negotiable

A person taking a cheque crossed generally or specially, bearing in either case the words not negotiable, shall not have, and shall not be capable of giving, a better title to the cheque than that which the person from whom he took it had.

Dishonour of certain cheques for insufficiency of funds

Provided that nothing contained in this section shall apply unless-

i. the cheque has been presented to the bank within a period of three months from the date on which it is drawn or within the period of its validity, whichever is earlier;
ii. the payee or the holder in due course of the cheque, as the case may be, makes a demand for the payment of the said amount of money by giving a notice in writing, to the drawer of the cheque within thirty days of the receipt of information by him from the bank regarding the return of the cheque as unpaid; and
iii. The drawer of such cheque fails to make the payment of the said amount of money to the payee or as the case may be, to the holder in due course of the cheque within 15 days of the receipt of the said notice.

Explanation - For the purposes of this section, debt or other liability means a legally enforceable debt or other liability.

Section 118 - Presumptions as to Negotiable Instruments

Until the contrary is proved, the following presumptions shall be made:

a. **Of consideration**. - that every negotiable instrument was made or drawn for consideration, and that every such instrument, when it has been accepted, indorsed, negotiated or transferred, was accepted, indorsed, negotiated or transferred for consideration;

b. **As to date**. - That every negotiable instrument bearing a date was made or drawn on such date;
c. **As to time of acceptance**. - That every accepted bill of exchange was accepted within a reasonable time after its date and before its maturity;
d. **As to time of transfer**. - That every transfer of a negotiable instrument was made before its maturity;
e. **As to order of endorsements**. - That the endorsements appearing upon a negotiable instrument were made in the order in which they appear thereon.
f. **As to stamp**. - That a lost promissory note, bill of exchange or cheque was duly stamped;
g. **That holder is a holder in due course**. - That the holder of a negotiable instrument is a holder in due course;

Provided that, where the instrument has been obtained from its lawful owner, or from any person in lawful custody thereof, by means of an offence or fraud, or has been obtained from the maker or acceptor thereof by means of an offence or fraud, or for unlawful consideration, the burden of proving that the holder is a holder in due course lies upon him.

Cheque and Demand drafts (DD) are both negotiable instruments. Both are mechanisms used to make payments.

Among the above mentioned negotiable instruments banks authenticates the Cheques, Demand Drafts and Challan as a part of their services but not according to any act.

A cheque is a Bill of Exchange drawn on a specified banker and not expressed to be payable otherwise than on demand.

Demand Draft is a pre-paid Negotiable Instrument, wherein the drawee bank acts as guarantor to make payment in full when the instrument is presented.

Challan: It refers to many things as per as Banking is concerned and depends upon the Banks also. In general term, pay in slip, or deposit challan is been referred as Bank challan.

In some cases, for Govt. payments they have a separate printed form thru which some of the payments are been done, which they refer as Bank challan in govt. sector.

Differences Between a Cheque and Demand Draft

1. In a business transaction cheque is not usually accepted as the drawer and payee are unknown and there will be credit risk. So, in such cases Demand draft is accepted where the transfer of money is guaranteed.
   Let us understand this with an example. Let us say that you want to make payment for the purchase of a flat. On the day of registration, if you hand over a cheque and the property is registered and the cheque bounces for some reason, you cannot reverse a property that is registered.
2. In a demand draft there is guaranteed payment by the banker and there is no question of it bouncing. The biggest difference between a cheque and a DD is that the payment is always honoured.

Here are few other differences between cheque and DD:

1. Cheque is issued by customer, whereas Demand draft is issued by the bank.
2. In cheque payment is made after presenting cheque to bank, while in DD is given after making payment to bank.
3. Cheque can bounce due to insufficient balance . DD cannot be dishonoured as amount is paid beforehand.
4. Payment of cheque can be stopped by drawee, whereas payment cannot be stopped in DD.
5. A cheque can be paid to bearer or order. While, DD is paid to person on order.
6. In cheque drawer and payee are different person. In DD, both parties are banks.
7. A cheque needs signature to transfer amount, While DD does not require signature to transfer funds

However, banks do charge certain amount depending on the amount on Demand draft. Outstation cheque are also charged.

Cheques and demand draft are increasingly losing their place as instruments that are used for payments. This is because, most individuals are today making payments through the RTGS and NEFT mechanism. These methods are faster than the traditional methods and there is also no worry of dishonour of a cheque.

Having said that there is a minimum charge that is applicable on NEFT and RTGS transactions. The charges though are very nominal and compared to the convenience, these are much better way of remittance as compared to demand drafts and cheques.

BASIS FOR COMPARISON	**CHEQUE**	**DEMAND DRAFT**
Meaning	Cheque is a negotiable instrument which contains an order to the bank, signed by the drawer, to pay a certain sum of money to a specified person.	Demand Draft is a negotiable instrument used for the transfer of money from one place to another.
Payment	Payable either to order or to bearer.	Always payable to order of a certain person.
Issuance	Cheque is issued by an individual.	Demand Draft is issued by a bank.
Bank Charges	No	Yes
Drawer	Customer of the bank.	Bank itself.

BASIS FOR COMPARISON	CHEQUE	DEMAND DRAFT
Parties Involved	Three Parties- Drawer, Drawee, Payee.	Two Parties- Drawer, Payee.
Dishonour	Yes, due to insufficient balance or other similar reasons.	No

Types of Cheques:

The following details are necessary in a cheque –

- A cheque must be drawn upon a specified bank (Drawee).
- A cheque must be signed by the person (Drawer) issuing the cheque.
- A cheque must have the name of the recipient (Payee) of the cheque.
- A cheque must mention the amount of money in words and figures.
- A cheque must be dated.

Classification of Cheques:

A cheque is one of the safest modes of making payment as there is an entry against the cheque honoured by the bank that can be traced back if needed.

Based on the location, cheques are classified as: –

Local cheques: If issued by a bank in the same city as the payee.

Outstation cheques: If a given city's local cheque is presented elsewhere it becomes an outstation cheque and may attract some nominal but fixed banking charges.

At par cheque: It is a cheque which is accepted at par at all its branches across the country. Unlike local cheque it can be present across the country without attracting additional banking charges.

Based on its value, cheques are classified as: –

Normal Value cheques: Cheques below the amount of Rs. 1 lakh are called normal value cheques.

High Value cheques: Cheque bearing an amount higher than Rs. 1 lakh is a high value cheque.

Gift cheques: Cheques used for gifting money to loved ones are gift cheques. The value may vary from Rs. 100 to Rs. 10,000.

Cheques are mainly of four types:-

1. **Uncrossed / Open Cheque:** When a cheque is not crossed, it is known as an "Open Cheque" or an "Uncrossed Cheque". The payment of such a cheque can be obtained at the

counter of the bank. An open cheque may be a bearer cheque or an order one: A cheque is called open when it is possible to get cash over the counter at the bank. The holder of an open cheque can receive payment over the counter at the bank, deposit the cheque in his own account or pass it to someone else by signing on the back of a cheque.

2. **Bearer cheque:** A cheque which is payable to any person who presents it for payment at the bank counter is called 'Bearer cheque'. A bearer cheque can be transferred by mere delivery and requires no endorsement. When the words "or bearer" appearing on the face of the cheque are not cancelled, the cheque is called a bearer cheque. The bearer cheque is payable to the person specified therein or to any other else who presents it to the bank for payment. However, such cheques are risky; this is because if such cheques are lost, the finder of the cheque can collect payment from the bank.

3. **Order cheque:** It is the one which is payable to a particular person. In such a cheque the word 'bearer' may be cut out or cancelled and the word 'order' may be written. The payee can transfer an order cheque to someone else by signing his or her name on the back of it.

4. **Crossed cheque:** When a cheque is crossed, the holder cannot encash it at the counter of the bank. The payment of such cheque is only credited to the bank account of the payee. Crossed cheque is done by drawing two parallel lines across top left corner of the cheque, with or without writing 'Account payee' in the space between the lines.

Types of crossing

General crossing

A crossed cheque generally is a cheque that only bears two parallel transverse lines, optionally with the words 'and company' or '& Co.' (or any abbreviation of them) on the face of the cheque, between the lines, usually at the top left corner or at any place in the approximate half (in width) of the cheque. In the UK, the crossing is across e cheque by the person who originally wrote the cheque (the drawer), or it can legitimately be added by the person the cheque is payable to (the payee), or even by the bank that the cheque is being paid into.

Generally-crossed cheques can only be paid into a bank account, so that the beneficiary can be traced. A crossed cheque on its own does not affect the negotiability of the instrument.

Restrictive or special crossings

Where some customary instruction is written between the two parallel transverse lines (constituting crossing of cheque) that may result in imposing certain restrictions on the collecting or paying banker, it is called restrictive crossing. The example is "A/c Payee only" or "State Bank of India". In these cases, the respective restrictions mandates to pay the cheque in the account of the payee only or to pay the cheque through State Bank of India (acting as collecting banker) only.

Banks also offer various cheques which guarantee payments.

A self cheque: is written by the account holder as pay self to receive money in physical form from the branch where he holds his account. This can be alternated by using an ATM card.

Anti-Dated Cheque: If a cheque bears a date earlier than the date on which it is presented to the bank, it is called as "anti-dated cheque". Such a cheque is valid up to three months from the date of the cheque.

Post-Dated Cheque: If a cheque bears a date which is yet to come (future date) then it is known as post-dated cheque. A post dated cheque cannot be honoured earlier than the date on the cheque. A PDC is a form of a crossed or account payee bearer cheque but post-dated to meet the said financial payment at a future date. The cheque is valid from the date of issue to three months.

Stale Cheque: If a cheque is presented for payment after three months from the date of the cheque it is called stale cheque. A stale cheque is not honoured by the bank.

A Banker's cheque: A banker's cheque is issued by a bank drawing money from its own funds rather than that from an account holder's. Banker's cheque is issued after the bank verifies the account status of the requestor and the amount is immediately deducted from the customer's account. A banker's cheque cannot be dishonoured as in the case of a normal cheque, when an account holder has insufficient funds in his/her account. Though different from a normal cheque it requires clearing too.

A Traveller's cheque: It is a printed open type cheque issued as an alternate for carrying around cash while travelling abroad or on a vacation to a foreign country as they come with a replacement guarantee and lifelong validity. Traveller's cheques are widely accepted by merchants, restaurants and other recreational organizations. The unused cheques from the recent trip can be used for your next trip.

ACCOUNT PAYEE CHEQUE: When two parallel lines along with a crossed made on the cheque and the word 'ACCOUNT PAYEE' written between these lines, then that types of cheques are called account payee cheque. The payment of the account payee cheque taken place on the person, firm or company on which name the cheque issue.

Mutilated Cheque: If a cheque is torn into two or more pieces such cheque is Mutilated Cheque. If it presented for payment, such a cheque the bank will not make payment against such a cheque without getting confirmation of the drawer. In case, if a cheque is torn at the corners and no material fact is erased or cancelled, the bank may make payment against such a cheque.

Bounced Cheque: A bounced check is a check that cannot be processed because the account holder has non-sufficient funds (NSF). Banks return or bounce these checks, also known as a rubber checks, rather than honouring them, and banks charge the check writers NSF fees.

Cancelled Check: A cancelled check is a check that has cleared the depositor's account and has been marked "cancelled" by the bank. A cancelled check has been paid by the drawee bank and endorsed by the payee, the payee's bank and the Federal Reserve Bank. Cancelled checks can also be used as proof of payment.

Outstanding Check: An outstanding check is a financial instrument that draws on the funds in an individual's or business' bank account but which has not yet been cashed or deposited by the payee. An outstanding check represents a liability for the payer. The payer must be sure to keep enough money in the account to cover the amount of the outstanding check until it is cashed, which could take weeks or even months.

Inward clearing of Cheque means the cheques received by the bank from other banks.

Outward clearing of Cheque: Outward clearing refer to instruments that are deposited by customers that are drawn on other banks that need to be presented at clearing. That can be further divided to –

- Local Clearing (instruments drawn on banks in that city),
- Outstation Clearing (Instruments drawn on banks outside the city). These may be within the country or on banks in other country.

A blank cheque or carte blanche: in the literal sense, is a cheque that has no numerical value written in, but is already signed. In the figurative sense, it is used to describe a situation in which an agreement has been made that is open-ended or vague, and therefore subject to abuse, or in which a party is willing to consider any expense in the pursuance of their goals.

Cheque Truncation System (CTS) or Image-based Clearing System (ICS): In India, is a project of the Reserve Bank of India (RBI), commencing in 2010, for faster clearing of cheques.CTS is based on a cheque truncation or online image-based cheque clearing system where cheque images and magnetic ink character recognition (MICR) data are captured at the collecting bank branch and transmitted electronically.

Cheque truncation means stopping the flow of the physical cheques issued by a drawer to the drawee branch. The physical instrument is truncated at some point en route to the drawee branch and an electronic image of the cheque is sent to the drawee branch along with the relevant information like the MICR fields, date of presentation, presenting banks etc. This would eliminate the need to move the physical instruments across branches, except in exceptional circumstances, resulting in an effective reduction in the time required for payment of cheques, the associated cost of transit and delays in processing, etc., thus speeding up the process of collection or realization of cheques.

Steps to correctly fill up a cheque:

1. Fill in the date. This is called the date of issue.
2. Mention the correct date in the top right column. It is day, month and year in figures.
3. A cheque once issued is valid for the next 3 months.
4. Sometimes, a cheque may require a future date to be written on it. Such a cheque is called a post-dated cheque (PDC). This means that the cheque cannot be cashed until that day. People tend to write a post-dated cheque because when they do not want it to be encased or deposited before a particular date. This is often used when one has to pay out a loan or a Monthly Instalment which will be paid out at a future date.
5. Write the name of the person/ company (Payee) you want to address the cheque to.
6. Make sure you spell the name in the same way as it appears on the beneficiary's account.
7. If the name does not match, the cheque will not be valid for payment.

8. It is advisable to strike out 'or bearer' at the end of the 'payee' line.

9. This will ensure that the cheque is encased only to the person it is addressed to and not to just anyone who holds it.

10. Write the amount to be paid in words along the 'Rupees' column. Strike a line after you fill in the amount in order to prevent any alteration.

11. Rewrite the exact same amount in figures within the adjacent box.

12. Say to pay a sum of 1000 Rupees, write One Thousand only (in words); 1000/- (in figures) in the box.

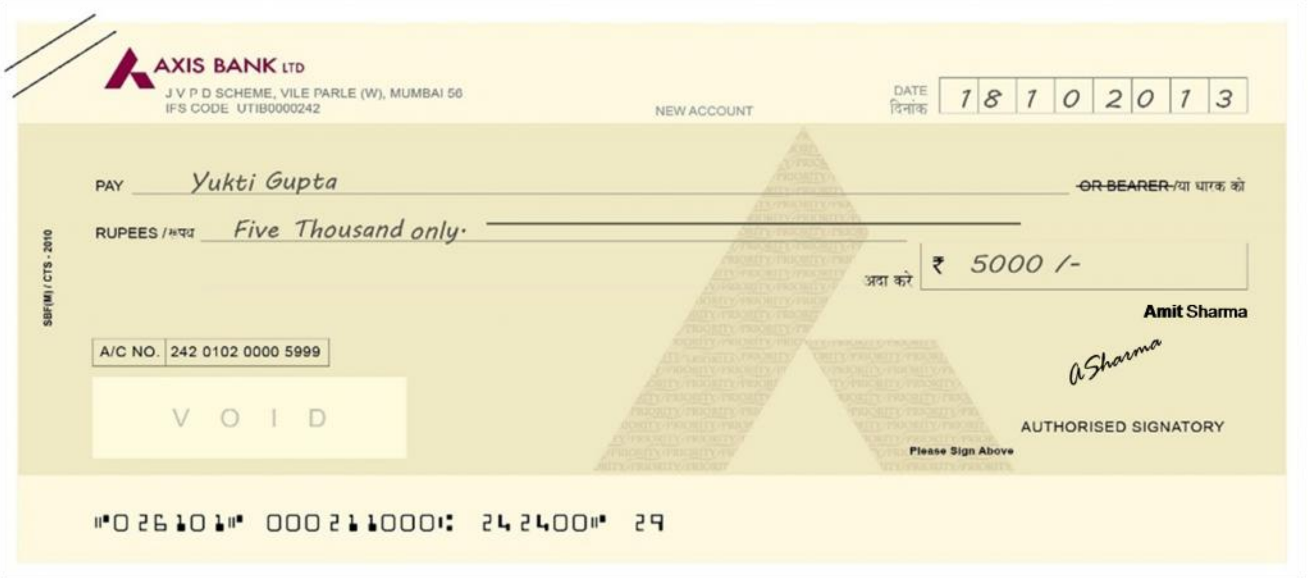
13. Put your signature above your name to authorize the transaction. This should be the same or closest likeness of the signature specimen you have submitted to your bank while opening your account.

14. The name and account number of the holder is usually already printed on the cheque leaf. If it is not, carefully write your name in BLOCK letters and enter your Account Number in the designated box.

15. Sometimes, in order to secure a cheque, you may mark out two parallel lines with 'Account Payee only' written in the middle, on the top left corner of the cheque. This is called 'Crossing out a Cheque'. This means your cheque will be paid into the account of the person being paid and not to the person holding the cheque for payment at the counter.

16. Follow this carefully to direct the amount transfer into the account of the right Payee. It is an important step to safeguard your money.

17. To cancel a cheque mark 'CANCEL' in bold across the face of the cheque and if possible, inform the bank officials or make a note of the cheque number and record it as cancelled. You should also mutilate the MICR code of your cancelled cheque or shred the whole cheque. You should additionally scratch out your signature on the cheque.



MICR CODE: MICR (Magnetic Ink Character Recognition), as name suggest it is a character recognition technology which helps in faster processing of cheques. Every bank branch is given a unique MICR code and this helps the RBI to identify the bank branch and speed up the cheque clearing process. Customer can find a magnetic inks bar codes printed on the bottom of bank's cheque leaves.

How MICR Code Is Formed?

It is a nine digit numeric code where each three digits signifies some important information about the bank and the transaction. The first three digits of the MICR represent the city code which indicates the city in which the bank branch is located. In most of the cases it is the first three numbers of PIN code like for Delhi the first three numbers is going to be '110'. The next three digits represent the bank code i.e. the identity of the bank and the last three digits represents the bank branch code i.e the identity of the location of the bank branch.

Example: 110229003

110	CITY CODE (DELHI)
229	BANK CODE (ICICI BANK)
003	BANK BRANCH CODE (GURGAON)

1.7. Customer Relationship Management:

One of the unique challenges of business banking in a digital world is meeting customer expectations. You can't just have a great checking account or lending terms, as you can with most retail customers. You must offer sound financial advice. And in the information age, that means having in-depth knowledge of each customer's industry, taking a tailored approach, and doing it all faster than ever before. Your corporate customers want goal-based planning, proactive insights, personalized outreach, and more. As fintechs create seamless, effortless, personalized experiences for customers, including in the banking space, business banks should follow suit or risk falling behind in the competitive landscape.

With all that's expected of banks, a Customer Relationship Management (CRM) solution is no longer optional. It's critical to your success. A great CRM can help any company market to new customers, close the deal, and provide excellent customer service, but the benefits of a CRM in business banking are especially lucrative. Here are some of those benefits and how you can become the bank that customers love with the right banking CRM solution.

CRM stand for in banking:

Just as in other industries like retail or business, in banking, CRM stands for Customer Relationship Management. A Customer Relationship Management solution in banking helps banks manage customers and better understand their needs in order to provide the right solutions, quickly. There are many specific benefits of CRM in banking.

Benefits of CRM in banking:

- Boosted Sales
- Increased Lead Conversion
- Personalized Customer Journeys
- Increased Productivity
- More Efficient Communication
- Inter-Department Data Tracking
- Better Service
- Improved Customer Experience
- Increased Customer Loyalty

Boosted Sales

On average, business banks loan out 15 times more money than consumer lenders. The stakes are high if you want to earn those big business accounts, and you need a great CRM to launch you ahead of the competition. Identify, nurture, and convert leads into deals before the other guys even know what hit them.

Increased Lead Conversion

Implementing CRM in banking enables deeper and more customized customer interactions.

With CRM banking technology, each department can access the same information across all customer profiles, while also setting up individual triggers for offering additional services. Employees can look up rich customer profiles compiled from marketing, sales, and service data to identify new opportunities to convert leads. They won't have to start from scratch every time an interdepartmental lead comes through the funnel, so they'll create a seamless and personalized experience for the customer and a streamlined conversion process for you.

Personalized Customer Journeys

Customer retention is critical, but in order to keep your bank growing, you also need a constant flow of new customers. How do you find them? What's the best way to reach out to them? How can you improve your marketing? A CRM for financial services can help you answer all of these questions so you can provide your institution with a steady stream of new and ready leads.

While drawing in loads of customers is great, keeping track of and following up with each individual customer can overload your staff. So how do you create targeted, successful ad campaigns without knowing who your customers are and what they want? Well… you can't. You need as much data as possible, but without proper organization, you won't be able to see the trends. A great banking CRM allows you to create reports and graphic representations of key data points and trends, which makes it easy to share with your team, drive your marketing strategy, and keep your customers happy all the while.

You can see everything you need to know about each customer with Sales force Marketing Cloud. Wondering how many leads can you trace back to last month's social media campaign?

Which of your web pages gets the most attention? Who's talking about you and what are they saying? It's all there.

A bank's CRM solution can help keep track of customer behaviours and predict needs, and then automatically send out suggestions for how the bank can fulfil those needs with a tailored product offering.

Increased Productivity

Nearly eight in 10 (79 percent) of all marketing leads are never converted to sales. Incredible, right? Let's say you have a full sales team. Would you hire an additional banker if, on average, he single-handedly increased loan sales by 29 percent and offered a return of 5.6 times his salary in revenue? It's a no brainer.

What if you could get these results with technology solutions instead of a new hire? You can, because that's exactly what a CRM for financial services can do for your bank. CRMs help cut costs by minimizing repetitive administrative tasks, streamlining proposals, and keeping your sales team in the loop with just a few clicks. With the right technology, bankers are capable of handling more accounts in less time.

More Efficient Communication

Social media. Email marketing. Website traffic. Search engines. Marketing has come a long way from newspaper ads and billboards. Going digital has had its benefits, such as enabling banks to reach more businesses with lower advertising costs. This dependence on technology also presents its own challenges. Conversations about your brand are now happening more quickly and publicly than ever, and one angry customer can muddy your brand's reputation with just a few keystrokes. Since customers are twice as likely to talk about their bad experiences than good ones, you could be looking at a PR nightmare at any moment if you don't find solutions.

A CRM can help you monitor the web for conversations about your brands and products. It can also make it easier for you to respond quickly in a way that puts out the fire instead of stoking the flames.

Inter-Department Data Tracking

Today, marketing is a data-driven field. But likes, clicks, and visits aren't the only data points that can help improve your marketing. You need to know how many of those behaviours lead to successful sales. When potential clients speak to your bankers, what are their top concerns, and can they be addressed in your marketing to better prime businesses for the sale? What parts of the loan process give customer's problems or prevent them from becoming raving fans of your bank?

The right CRM can track data from several departments, so a call to customer service or a lost account becomes an opportunity to prepare potential customers to love banking with you—before they ever speak to a banker.

Improved Customer Experience

With 300 different products and thousands of branches across the country, the head of a leading US bank's Wholesale Service Group calls the financial institution a "relationship bank." He cites the use of Sales force as key to maintaining customer satisfaction. Since many Wells Fargo customers use dozens of Wells Fargo products, they often need help across many departments and don't know who to call with specific questions.

Even if your bank has only a few dozen distinct products, your customer service depends on answering questions and solving problems quickly, without handing the customer off to department after department. With a good banking CRM, you can easily keep all departments on the same page and quickly provide each customer with solutions.

Increased Customer Loyalty

What's the true test of how much you value your customers? Customer retention through customer service. Although well-timed sales and offering products based on customer needs are important, 76 percent of consumers say customer service is a primary factor in how they value a brand. Great service is the part of the sales funnel that keeps your customers coming back for more.

How can a CRM help? By giving you access to rich customer profiles with just a few clicks. Your customers have businesses to run, so asking them to repeat their issue or customer history each time they speak to a new representative stretches their patience and wastes your time and theirs. Instead, you can instantly pull up every service ticket, purchase, and data point at the precise moment customers need help so you can swoop in to save the day. When you use a CRM solution to stay on top of customer service tickets and personalize your response, you can turn issues into opportunities for increasing loyalty and satisfaction.

Conclusion

CRM solutions are no longer limited to just the retail or business verticals; rather, they are now essential for any entity that offers goods or services. When it comes down to it, business banks share an important challenge with their own customers: Banking is now a customer-driven world. Banks that understand and serve the individual needs of their customer's best will succeed, while those who still use sticky notes to keep track of accounts will lose market share and fade away. Adopting banking CRM is critical to serving your customers at every point in the sales funnel, so don't get left behind.

1.8. KYC system:

Know Your Customer (KYC) refers to both:

- The activities of customer due diligence that financial institutions and other regulated companies must perform to identify their clients and ascertain relevant information pertinent to doing financial business with them
- And the bank regulation which governs those activities

In the USA, KYC is typically a policy and process implemented to conform to a customer identification program (CIP) mandated under the Bank Secrecy Act and USA PATRIOT Act. Know your customer policies are becoming increasingly important globally to prevent identity theft, financial fraud, money laundering and terrorist financing.

Policy on Know Your Customer Standards/Anti-Money Laundering Measures

The RBI u/s 35 A of Banking Regulation Act has issued directive to banks to put in place KYC policy and adopt anti-money laundering measures.

On the recommendations of the United Nations, the Government of India has enacted Prevention of Money Laundering Act 2002. Money laundering is the process whereby proceeds of crimes, such as, drug trafficking, smuggling, etc. are converted into legitimate money through a series of financial transactions making it impossible to trace back the origin of funds. Further, the technological advancements have helped money launderers to adopt innovative means and move funds faster across continents making detection and preventive action much more difficult. The international community considers money laundering a serious crime. This calls for a dynamic approach in tracking the crime. Bank officials need to be even more vigilant and prudent in knowing their customers. Bank employees have to undertake enhanced due diligence while opening accounts and also monitor operations more closely. "Know Your Customer" also means knowing whom he deals with.

Objectives

The objectives of the policy are to prevent criminal elements from using the bank for money laundering activities by enabling the bank to know/understand the customers and their financial dealings better, which, in turn, would help the bank to manage risks prudently and to put in place appropriate controls for detection and reporting of suspicious activities in accordance with the laid down procedures so as to comply with applicable laws and regulatory guidelines.

Money Laundering - Risk Perception

The inadequacy or absence of KYC standards can subject the bank to serious customer and counter-party risks:

- **Reputation Risk**: Risk of loss due to severe impact on the bank's reputation. This may be of particular concern given the nature of the bank's business which requires the confidence of depositors, creditors and the general market place.
- **Compliance Risk**: Risk of loss due to failure of compliance with key regulations governing the bank's operations.
- **Legal Risk**: Legal risk is the possibility of lawsuits, adverse judgments or contract resulting from failure to observe mandatory KYC standards or from the failure to practice due diligence. Consequently, the banks can suffer fines, criminal liabilities and special penalties imposed by supervisor.

The international community considers money laundering a serious crime. This calls for a dynamic approach in tracking the crime. Bank officials need to be even more vigilant and prudent in knowing their customers.

Section 12 of PML Act 2002 has placed certain obligations on every banking institution and intermediary, which include - (i) Maintaining a record of prescribed transactions, (ii) Furnishing information of prescribed transactions to the specified authority, (iii) Verifying and maintaining records of the identity of its clients (iv) Preserving records in respect of (i), (ii) and (iii) above for a period of ten years from the date of cessation of transactions with the clients.

Definition of Customer

A customer for the purpose of this policy is defined as: (i) a person or an entity that maintains an account and/or has a business relationship with the Bank; (ii) one on whose behalf the account is maintained (i.e. the beneficial owner); (iii) beneficiaries of transactions conducted by professional intermediaries, such as Stock Brokers, Chartered Accountants, Solicitors, etc. as permitted under the law; and (iv) any person or entity connected with a financial transaction which can pose significant reputational or other risks to the bank.

Key Elements of the Policy

i. Customer Acceptance Policy

ii. Customer Identification Procedures

iii. Monitoring of Transactions and

iv. Risk Management

Customer Acceptance Policy: The Bank will:

1) classify customers into various risk categories and based on risk perception decide on acceptance criteria for each category of customers;

2) accept customers after verifying their identity as laid down in Customer Identification Procedures;

3) Not open accounts in the name of anonymous/fictitious/benami persons; and

4) while carrying out due diligence, ensure that the procedure adopted will not result in denial of banking services to the general public especially those who are financially or socially disadvantaged.

Customer Identification Procedures: The first requirement of customer identification procedures to be satisfied that

1) A prospective customer is who he/she claims to be,

2) The second requirement of customer identification procedures is to ensure that sufficient information is obtained on the nature of the business that the customer expects to undertake, and any expected, or predictable, pattern of transactions and the information collected will be used for profiling the customer,

3) The identity is to be verified for:

    a. The named account holder;

b. The beneficial owners;

c. The signatories to an account; and

d. The intermediary parties,

4) The Customer Identification Procedures are to be carried out at the stages:

a. While establishing a banking relationship;

b. When the bank feels it is necessary to obtain additional information from the existing customers based on the conduct or behaviour of the account.

Documents to verify the name/identity of the customer: (a) passport, (b) PAN card, (c) voter identity card, (d) driving license with photograph, (e) identity card, (f) letter from a recognized public authority verifying the identity and residence of the customer to the satisfaction of the branch official authorized to open the account, (g) confirmation/letter from employer/other bank (subject to satisfaction of the branch official authorized to open the account).

Documents to verify the address are: Telephone bill, bank account statement, electricity bill, ration card, letter from employer to the satisfaction of the bank.

Attention of proper Introduction: The introducer must know and identify the customer and his profession; he himself should have satisfactorily operated account for at least six months and in his account, KYC norms must have been fulfilled.

Photograph: A set of two photographs should be obtained from customer.

Wherever applicable, information on the nature of business activity, location, mode of payments, volume of turnover, social and financial etc. will be collected for completing the profile of the customer.

Risk Perception: Risk in various accounts will be based on: (I) Type of customer, (II) Type of products and services availed by the customer, and (III) Country where the customer is domiciled.

Customers will be classified into three risk categories namely High, Medium and Low, and Negligible based on the risk perception. The risk categorization will be reviewed periodically. Customer Identification Procedures will also be carried out in respect of non-account holders approaching bank for high value one-off transaction.

High Risk Category: High Risk Customers; Customers engaged in certain professions; firms with sleeping partner(s), politically exposed persons of foreign origin; close relatives of politically exposed persons; trusts, charities, NGOs, religious/social organizations and the organizations receiving donations; where accounts are opened/operated through a mandate or power of attorney; persons/entities with dubious reputation as per the information available in public domain, non-face-to-face customers.

High Risk Countries: Without anti-money laundering and regulations; Politically unstable regime with high level of public/private sector corruption; known to be drug producing or drug transit countries; non-cooperative country as classified by Financial Action Task Force (FATF).

Medium Risk category: Medium Risk country (nationality is irrelevant); Current Account customers where credit or debit summations exceed Rs. 50 lakh per annum in their accounts, but they do not provide sufficient documentary proof and other deposit account customers where credit or debit summations exceed Rs.10 lakh per annum in their accounts, but they do not provide sufficient documentary proof.

Low Risk category: All customers not falling under the category of High/Medium Risks are to be classified under Low Risk category. All borrowable customers, where due diligence is exercised at the time of granting the credit facilities.

Negligible Risk category or Applicability of reduced KYC Procedure: Where a customer intends to keep balance is not exceeding Rs 50,000/- in all his/her accounts taken together in the Bank and total credit in all the accounts taken together not expecting to exceed Rs.2 lakh in a year. More so, he is not in a position to produce documents for the purpose of opening of account.

UNIT 2: BANKING REFORMS AND REGULATIONS

2.1. Banking regulation act-1949

Objectives of Banking Regulation Act 1949

The Banking Act was enacted in February1949 with the following objectives:

i. The provision of the Indian Companies Act 1913 was found inadequate and unsatisfactory to regulate banking companies in India. Therefore a need was felt to have a specific legislation having comprehensive coverage on banking business in India.

ii. Due to inadequacy of capital many banks failed and hence prescribing a minimum capital requirement was felt necessary. The banking regulation act brought in certain minimum capital requirements for banks.

iii. One of the key objectives of this act was to avoid cut throat competition among banking companies. The act was regulated the opening of branches and changing location of existing branches.

iv. To prevent indiscriminate opening of new branches and ensure balanced development of banking companies by system of licensing.

v. Assign power to RBI to appoint, reappoint and removal of chairman, director and officers of the banks. This could ensure the smooth and efficient functioning of banks in India.

vi. To protect the interest of depositors and public at large by incorporating certain provisions, viz. prescribing cash reserve and liquidity reserve ratios. This enable bank to meet demand depositors.

vii. Provider compulsory amalgamation of weaker banks with senior banks, and thereby strengthens the banking system in India.

viii. Introduce few provisions to restrict foreign banks in investing funds of Indian depositors outside India.

ix. Provide quick and easy liquidation of banks when they are unable to continue further or amalgamate with other banks.

Banking Reforms and Regulations

Bank is the main confluence that maintains and controls the "flow of money" to make the commerce of the land possible. Government uses it to control the flow of money by managing Cash Reserve Ratio (CRR) and thereby influencing the inflation level. The functions of the bank include accepting deposits from the public and other institutions and then to direct as loans and advances to parties mainly for growth and development of industries. It extends loans for the purpose of education, housing etc. and as a part of social duty, some percentage to Agricultural sector as decided by the RBI. The banks take the deposit at the lower rate of interest and give loans at the higher rates of interest. The difference in this transaction constitutes in number of banks the main source of income.

Banking in India has undergone startling changes in terms of growth and structure. Organized Banking was active in India since the establishment of The General Bank of India in 1786. The

Reserve Bank of India (RBI) was established as the central bank and in 1955. The Imperial bank of India, the biggest bank at that time, was taken over by the government to form State owned State Bank of India (SBI). RBI undertook an exercise to reduce the fragmentation in the Indian Banking Industry post-independence by merging weaker banks with stronger banks. The total number of banks reduced from 566 in 1951 to 85 in 1969.With the objective of reaching out to the masses and servicing credit needs of all sections of people, the government nationalized 14 large banks in 1969 followed by another six banks in 1980. This period saw the enormous growth in the number of branches and the bank's branch network became wide enough to reach the weaker section of the society in a vast country like India.

The economic reforms unleashed by the government in early nineties included banking sector too, to a significant extent. Entry of new private banks was permitted by RBI under specific guidelines. A number of liberalization and deregulation measures like efficiency, asset quality, capital adequacy and profitability have been introduced by the RBI to bring Indian banks in line with International best practices. With a view of giving the State owned banks operational flexibility and functional autonomy, partial privatization has been authorized as a first step, enabling them to reduce the stake of the government to 51%. Beside that a number of the legislation aims at protecting the interests of the depositors, ensuring control over the volume of credit, streamlining procedure, evolving uniform banking practices and developing banking on sound lines. The central banking enquiry committee stated that the banking institutions of a country serve as a repository of the cash resources of all classes of individuals and exercise a very powerful influence on the economic life of the people. Since banking business has come to be regarded as quasi-public in its nature warranting legislation to safeguard the interest of depositors, on whose confidence rests the entire banking structure of a nation and for ensuring and fostering the growth of banking on sound lines.

Legislation for safeguarding the business of banking companies most intensively was undertaken after the failure of the Travancore National and Quilon Bank. Between January 1937 and September 1948, three amendments to the Indian Companies Act were promoted. Meanwhile, a bill regulating the business of banking introduced in November 1944 lapsed in October 1945. Another bill introduced in March 1946 was withdrawn because of numerous amendments which were found necessary and reintroduced in March 1948. This final version of the bill as modified by the select committee became law, which effect from March 16, 1949.

(A) Banking Regulation Act 1949

Banking regulation act came in existence in 1949 with numerous provisions which may be classified into two categories: (i) built in safeguards and (ii) power and consequential functions and responsibilities of the Reserve Bank of India. The other important set of provisions pertains to the suspension of business by and winding up of banking companies.

The provisions which fall in first category namely of built in safeguard relate to the organization management and operation of a banking company. The power and function of the RBI cover the entire gamut of operations of a bank and vest with adequate control and authority in this behalf.

The organizational, managerial and operations safeguard can be further categorized and examined under the following subheads:

I) Organizational Safeguard:

i) Business of banking companies: In addition to the business of banking, banking company may engage in any one or more of the following forms of business (U/s 6), namely:

(a) The borrowing, raising, or taking up of money; the lending or advancing of money either upon or without security; the drawing, making, accepting, discounting, buying, selling, collecting and dealing in bills of exchange*, hundis* promissory notes, coupons, drafts, bills of lading, railway receipts, warrants, debentures, certificates, scripts and other instruments, and securities whether transferable or negotiable or not; the granting and issuing of letters of credit, traveler's 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, scripts or other forms of securities on behalf of constituents or others, the negotiating of loans and advances; the receiving of all kinds of bonds, scripts or valuables on deposit or for safe custody or otherwise; the providing of safe deposit vaults; the collecting and transmitting of money and securities.

(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 forwarding of goods, giving of receipts and discharges and otherwise acting as an attorney on behalf of customers, but excluding the business of a 1[managing agent or secretary and treasurer] of a company.

(c) Contracting for public and private loans and negotiating and issuing the same;

(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 such issue;

(e) Carrying on and transacting every kind of guarantee and indemnity business;

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

(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 such security;

(h) Undertaking and executing trusts;

(i) Undertaking the administration of estates as executor, trustee or otherwise;

(j) Establishing and supporting or aiding in the establishment and support of association, institutions, funds, trusts and conveniences calculated to benefit employees or ex-employees of the company or the dependents or connections of such persons; granting pensions and benevolent objects or for any exhibition or for any public, general or useful object;

(k) The acquisition, construction, maintenance and alteration of any building or works necessary or convenient for the purposes of the company;

(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) Acquiring and undertaking the whole or any part of the business of any person or company, when such business is of nature enumerated or described in this sub-section;
(n) Doing all such other things as are incidental or conducive to the promotion or advancement of the business of the company;
(o) Any other forms 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.

Section 6 further provides that a banking company cannot engage itself in any other type of business. The rigidity ;of this provisions is strengthened by those of section 8 which specifically prohibit a banking company from engaging itself in any trade or buying and selling of goods except for realization of any security held by it. These in brief are the limitations which the act provides in respect of the business that a banking company may or may not transact.

Disposal of non-banking assets - Notwithstanding anything contained in Sec. 6, no banking company shall hold any immovable property, howsoever acquired, except such as is required for its own use, for any period exceeding seven years from the acquisition thereof or from the commencement of this Act, whichever is later or any extension of such period as in this section provided, and such property shall be disposed of within such period or extended period, as the case may be: Provided that the banking company may, within the period of seven years as aforesaid, deal or trade in any such property from the purpose of facilitating the disposal thereof. Provided further that the Reserve Bank may in any particular case extend the aforesaid period of seven years by such period not exceeding five years where it is satisfied that such extension would be in the interests of the depositors of the banking company.

Restriction on nature of subsidiary companies - A banking company shall not form any subsidiary company except a subsidiary company formed for one or more of the following purposes, namely: (a) the undertaking of any business which, under Clause. (a) to (o) of subsection (1) of Sec. 6, is permissible for a banking company to undertake, or *(b)* with the previous permission in writing of the Reserve Bank, the carrying on of the business of banking exclusively outside India, or (c) the undertaking of such other business, which the Reserve Bank may, with the prior approval of the Central Government, consider to be conducive to the spread of banking in India or to be otherwise useful or necessary in the public interest.

No banking company shall hold shares in any company, whether as pledge, mortgagee or absolute owner, of an amount exceeding thirty per cent of the paid-up share capital of that company or thirty per cent of its own paid-up share capital and reserves, whichever is less: Provided that any banking company which is on the date of the commencement of this Act holding any shares in contravention of the provisions of this sub-section shall not be liable to any penalty therefore if it reports the matter without delay to the Reserve Bank and if it brings its holding of shares into conformity with the said provisions within such period, not exceeding two years, as the Reserve Bank may think fit to allow. A banking company shall not, after the expiry of one year from the date of the commencement of this Act, hold shares, whether as pledge, mortgagee or absolute owner, in any company in the management of which any Managing Director or manager of the banking company is in any manner concerned or interested.

Use of words "bank", "banker", "banking" or "banking company" - (1) No company other than a banking company shall use as part of its name 15[or, in connection with its business] any of the words "bank", "banker" or "banking" and no company shall carry on the business of banking in India unless it uses as part of its name at least one of such words. (2) No firm, individual or group of individuals shall, for the purpose of carrying on any business, use as part of its or his name any of the words "bank", "banking" or "banking company". (3) Nothing in this section shall apply to- (a) a subsidiary of a banking company formed for one or more of the purposes mentioned in sub-section (1) of section 19, whose name indicates that it is a subsidiary of that banking company; (b) any association of banks formed for the protection of their mutual interests and registered under section 25 of the Companies Act, 1956.

II) Operational Safeguard: Operational sage guards are also provided in this Act which relate to

(i) Maintenance of cash reserves assets in India,

(ii) Grant of unsecured loans and advances and

(iii) Opening of new branches.

Maintenance of liquid resources: It is essential for a bank to maintain a satisfactory liquid position and many a bank have run into difficulties and come to grief for non-observance of this prime requirement even though they were ultimately found to be solvent. In fact, "liquidity" is the very foundation of banking because it represents the faith or confidence that the general public has, that banks will always meet their obligations. It is this faith or confidence which enables banks to attract and retain deposits. A bank is able to inspire this confidence by demonstrating, *inter alia,* its ability to repay its deposits as and when required in accordance with the tenure of the deposits; sometimes a bank may find it necessary even to repay a time deposit before its maturity. Every bank must, therefore, maintain the required "liquidity" or cash resources. As has been humorously remarked, "If a cheque is to be returned for insufficient funds, it should be because of insufficient funds in the depositor's account and not insufficient funds on the part of the bank."

The Act seeks to secure this healthy feature in the operations of commercial banks by prescribing a minimum liquidity ratio which they must maintain. As in the case of commercial banks, primary (urban) cooperative banks are also required to maintain certain amount of cash reserve and liquid assets. The scheduled primary (urban) cooperative banks are required to maintain with the Reserve Bank of India an average daily balance, the amount of which should not be less than 5 per cent of their net demand and time liabilities in India in terms of Section 42 of the Reserve Bank of India Act, 1934. Non-scheduled (urban) cooperative banks, under the provision of Section 18 of Banking Regulation Act, 1949 (As Applicable to Cooperative Societies) should maintain a sum equivalent to at least 3 per cent of their total demand and time liabilities in India on day-to-day basis. For scheduled cooperative banks, CRR is required to be maintained in accounts with Reserve Bank of India, whereas for non-scheduled cooperative banks, it can be maintained by way of either cash with themselves or in the form of balances in a current account with the Reserve Bank of India or the state co-operative bank of the state concerned or the central cooperative bank of the district concerned or by way of net balances in current accounts with public sector banks. In addition to the cash reserve, every primary (urban) cooperative bank (scheduled/non-scheduled) is required to maintain liquid assets in the form of cash, gold or unencumbered approved securities which should not be less than 25 per cent of the total of its demand and time liabilities in accordance with the provisions of Section 24 of the Banking Regulation Act, 1949 (As Applicable to Cooperative Societies). Out of the prescribed SLR, the UCBs have been advised to maintain a certain amount in the form of SLR Securities as under:

S No.	Category of bank	Minimum SLR holding in Government and other approved securities as percentage of Net Demand and Time Liabilities (NDTL)
1.	**Scheduled banks**	25%
2.	**Non-Scheduled banks** a) with NDTL of Rs.25 crore & above b) with NDTL of less than Rs.25 crore	15% 10%

The Act further requires that the assets in India of every banking company should not be less than 75 per cent of its demand and time liabilities in India. A banking company is also precluded from creating a floating charge on its assets and properties unless the creation of such charge is certified by the Reserve Bank as not being detrimental to the interests of the depositors of the banking company.

Unsecured and other loans and advances*:* The safeguards pertaining to loan and advances preclude a banking company from *(a)* granting advances against the security of its own shares, *(b)* granting unsecured advances of specified types and *(c)* writing offer remitting advances except with the prior approval of the Reserve Bank. A banking company cannot allow an unsecured advance to:

- Any of its directors
- To firms in which a director is a partner or guarantor
- A private limited company in which a director is a managing
- Agent or guarantor
- Any individual where a director is a guarantor

To any company in which the chairman of the banking company is *(i)* a chairman or managing director, if such a company has no managing agent or *(ii)* the managing agent or director or partner of the managing agent of such company.

To mitigate the hardships of the above blanket restrictions on the grant of unsecured advances, the Act has deleted advances made against bills of exchange arising out of bona fide commercial or trade transactions, supply bills and trust receipts, from the purview of unsecured advances.

Apart from the restrictions on the grant of unsecured loans and advances, the Act has laid down that advances, both secured and unsecured outstanding against *(i)* a director of a bank *(ii)* any firm or company in which any of the directors is interested as director, partner, managing agent or guarantor and *(iii)* any individuals if any of the directors is his partner or guarantor, cannot be remitted or written off in whole or in part without the prior approval of the Reserve Bank.

Opening New Offices: The third operational safeguard relates to the opening of new offices by banks. The Act, provides that, without obtaining prior permission of the Reserve Bank, no banking company shall open a new place of business in India.

Sec. 23 (2) of the Banking Regulation Act, 1949, clearly states: "Before granting any permission under this Section, the Reserve Bank may require to be satisfied by an inspection under Section 35 or otherwise as to the financial condition and history of the company, the general character of its management, the adequacy of its capital structure and earning prospects, and that public interest will be served by the opening or, as the case may be, change of location, of the place of business," of a banking institution.

This Section of the Act *inter alia* laid stress on the financial management, the adequacy of capital and the earning prospects of the bank. Public convenience as regards the location was also stressed. The then existing circumstances must have forced the Reserve Bank to lay greater stress on the functioning and the soundness of the bank. An uneven development of banking in the different areas of the country was even at that time engaging the attention of the Reserve Bank; but the promotion and building up of good business practices were considered to be primary objectives.

Miscellaneous Provisions: These are in brief the organizational, managerial and operational safeguards provided in the Act in respect of banking companies. The provisions relating to paid-up capital and reserves and maintenance of liquid resources and assets in India do not apply to a banking company which has been refused a license or whose license has been cancelled or which has been prohibited from accepting fresh deposits under any compromise, arrangement or scheme sanctioned by a court.

There are several other provisions which arise out of and/ or are ancillary to these safeguards. For example every banking company is, required to prepare its annual accounts comprising the balance sheet and profit and loss account in the forms prescribed under the Act. The accounts are required to be audited by a qualified auditor. The banking company is further required to publish its balance sheet and 'profit and loss account and to send copies thereof to the Reserve Bank of India as also to the Registrar of companies. Copies of such balance sheets and profit and loss account are also required to be displayed in a conspicuous place at its principal office and at its other offices.

Section 46 of the Act provides for punitive action against directions, officers and other persons for failure to comply with the provisions of the Banking Regulation Act. The offences for which punitive action can be taken are:

i. Willfully making a false statement or omitting a material statement in any retuin, balance sheet or other document;
ii. Failure to produce books and records or answer questions during an inspection under section 35;
iii. Receiving of deposits after a bank has been prohibited from accepting deposits;
iv. Failure to comply with any other provision of the Act.

Offences under the Banking Regulation Act so far have been neither serious nor numerous. The Reserve Bank usually does not take a serious view of petty contraventions which may have been the result of ignorance or inadvertence.

2.2. Reserve Bank of India Act-1934

The origins of the Reserve Bank of India can be traced to 1926, when the Royal Commission on Indian Currency and Finance – also known as the Hilton-Young Commission – recommended the creation of a central bank for India to separate the control of currency and credit from the

Government and to augment banking facilities throughout the country. The Reserve Bank of India Act of 1934 established the Reserve Bank and set in motion a series of actions culminating in the start of operations in 1935. Since then, the Reserve Bank's role and functions have undergone numerous changes, as the nature of the Indian economy and financial sector changed.

Origin of the Reserve Bank of India:

1) 1926: The Royal Commission on Indian Currency and Finance recommended creation of a central bank for India.
2) 1927: A bill to give effect to the above recommendation was introduced in the Legislative Assembly, but was later withdrawn due to lack of agreement among various sections of people.
3) 1933: The White Paper on Indian Constitutional Reforms recommended the creation of a Reserve Bank. A fresh bill was introduced in the Legislative Assembly.
4) 1934: The Bill was passed and received the Governor General's assent
5) 1935: The Reserve Bank commenced operations as India's central bank on April 1 as a private shareholders' bank with a paid up capital of rupees five crore (rupees fifty million).
6) 1942: The Reserve Bank ceased to be the currency issuing authority of Burma (now Myanmar).
7) 1947: The Reserve Bank stopped acting as banker to the Government of Burma.
8) 1948: The Reserve Bank stopped rendering central banking services to Pakistan.
9) 1949: The Government of India nationalised the Reserve Bank under the Reserve Bank (Transfer of Public Ownership) Act, 1948.

Functions of RBI:

The functions of the Reserve Bank today can be categorised as follows:

- Monetary policy Regulation and supervision of the banking and non-banking financial institutions, including credit information companies

- Regulation of money, forex and government securities markets as also certain financial derivatives

- Debt and cash management for Central and State Governments Management of foreign exchange reserves

- Foreign exchange management—current and capital account management

- Banker to banks Banker to the Central and State Governments Oversight of the payment and settlement systemsv Currency managementv Developmental rolev Research and statistics

Organization of RBI

Establishment

The central bank of our country is the Reserve Bank of India (RBI). The Reserve Bank of India was set up on the recommendations of the Hilton Young Commission. The commission submitted its report in the year 1926, though the bank was not set up for another nine years. It was established in April 1935 with a share capital of Rs. 5 crores. The share capital was divided into shares of Rs. 100 each fully paid which was entirely owned by private shareholders in the beginning. The government held shares of nominal value of Rs. 2,20,000.

Thus, 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 originally established in erstwhile Calcutta but was permanently moved to Mumbai in the year 1937. The Governor of RBI sits in the Central Office, where policies are formulated and finalized. Initially, RBI was privately owned but since nationalisation in 1949, the Reserve Bank is fully owned by the Government of India.

The Bank was constituted to fulfil the following needs:

1. To regulate the issue of banknotes
2. To maintain reserves with a view to securing monetary stability and
3. To operate the credit and currency system of the country to its advantage.

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."

Central Board

A central board of directors governs the Reserve Bank's affairs. The Government of India, in keeping with the Reserve Bank of India Act, appoints this board. The members of the board are:

1. Appointed/nominated for a period of four years
2. Constitution:
    i. Official Directors
        a. Full-time: Governor and not more than four Deputy Governors
    ii. Non-Official Directors
        a. Nominated by Government: Ten Directors from various fields and one government official
        b. Others: Four Directors – one each from four local boards.

The Reserve Bank of India was established on April 1, 1935 in accordance with the provisions of the Reserve Bank of India Act, 1934.

General Superintendence

General superintendence and direction of the Bank's affairs through:

Local Boards

1.One each for the four regions of the country in Mumbai, Calcutta, Chennai and New Delhi.

2. **Membership**: Consist of five members each, appointed by the Central Government for a term of four years.
3. **Functions:** To advise the Central Board on local matters and to represent territorial and economic interests of local co-operative and indigenous banks to perform such other functions as delegated by Central Board from time to time.

A central bank, reserve bank, or monetary authority, is an entity responsible for the monetary policy of its country.

Financial Supervision - Board for Financial Supervision (BFS)

The Reserve Bank of India performs financial supervision 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.

Objective

The primary objective of BFS is to undertake consolidated supervision of the financial sector comprising commercial banks, financial institutions and non-banking finance companies.

Constitution

The Board is constituted by co-opting four Directors from the Central Board as members for a term of two years and is chaired by the Governor. The Deputy Governors of the Reserve Bank are ex-officio members. One Deputy Governor, usually, the Deputy Governor in charge of banking regulation and supervision, is nominated as the Vice-Chairman of the Board.

BFS Meetings

The Board is required to meet normally once every month. It considers inspection reports and other supervisory issues placed before it by the supervisory departments.

BFS through the Audit Sub-Committee also aims at upgrading the quality of the statutory audit and internal audit functions in banks and financial institutions. The audit sub-committee includes Deputy Governor as the chairman and two Directors of the Central Board as members.

The BFS oversees the functioning of Department of Banking Supervision (DBS), Department of Non-Banking Supervision (DNBS) and Financial Institutions Division (FID) and gives directions on the regulatory and supervisory issues.

Initiatives Taken By BFS

Some of the initiatives taken by BFS include:

1. Restructuring of the system of bank inspections
2. Introducing off-site surveillance,
3. Strengthening of the role of statutory auditors and
4. Strengthening of the internal defences of supervised institutions.

Current Focus

1. Supervision of financial institutions
2. Strong and secure accounting
3. Legal issues in bank frauds
4. Divergence in assessments of non-performing assets (NPAs) and
5. Supervisory rating model for banks.

Independence of Central Bank

Advocates of central bank independence argue that a central bank which is too vulnerable to political direction or pressure may encourage economic cycles ("boom and bust"). Politicians may be tempted to boost economic activity in advance of an election, to the disadvantage to long-term health of the economy and the country.

Independence is usually defined as the central bank's operational and management independence from the government. On the other hand, an independent, privately owned "Central Bank" can, and has been proven in the past to have done as such (the Great Depression), create a boom and bust scenario for the profit of the owners and shareholders of the bank itself.

In addition, it is argued that an independent central bank can run a more credible monetary policy, making market expectations more responsive to signals from the central bank.

An "independent central bank" is one which operates under rules designed to prevent political interference.

Example: The Banco Central de Chile, the Reserve Bank of Australia, the Reserve Bank of India, the European Central Bank, the Bank of Canada etc.

Departments of RBI

The Reserve Bank of India has sixteen departments. These are:

1. **Issue Department**: This department issues paper currency and therefore, it also makes arrangement for the distribution of paper currency. It maintains regular accounts of the notes printed at Nasik Press. It has branches at the Bangalore, Mumbai, Kolkata, Hyderabad, Kanpur, Chennai, Nagpur, New Delhi and Patna.

2. **Banking Department**: This department performs two primary functions:

   i. Dealing with Government transactions and floating of loans on behalf of the Central and State Governments and arranging remittances of government funds from one place to another; and

   ii. The maintenance of cash reserves of scheduled banks, extending financial assistance to them whenever required, and functioning as the clearinghouse for the scheduled banks.

3. Banking Development: This department is concerned with the expansion of banking facilities in the rural and semi-urban areas. It also imparts training to the scheduled banks employees.

4. Banking Operation: This department undertakes:

i. Periodical inspections of the scheduled banks

ii. Analyses their balance sheets

iii. Issues licenses for opening of new banks

iv. Considers requests for opening new branches

v. Examines the requests of scheduled banks for increasing the paid up capital

vi. Examines the possibilities for the amalgamation of existing banks and tenders advised to the scheduled banks in their day-to-day functioning.

5. **Agricultural Credit**: This department:

i. Studies the problems connected with agricultural credit

ii. Conducts research on rural credit problems

iii. Formulates rural credit policy of the Reserve Bank

iv. Grants rural credit to state governments and state co-operative banks and publish reports on agricultural credit.

6. **Exchange Control**: This department regulates and controls the sale and purchase of foreign exchange.

7. **Industrial Finance**: This department extends financial assistance to small scale and medium scale industries and also tenders advice to industrial financial corporation's for their routine working.

8. **Non-Banking Companies**: This department based at is chiefly concerned with the supervision of the non-banking companies and financial institutions in the country.

9. **Legal Department**: This department gives advice to the various departments of the Bank on legal matters, prepares directives and official reports of the Bank and gives advice to the Bank on the proper implementation of legal matters relating to banking in the country.

10. **Research and Statistics**: This department:

i. Undertakes research on problems in the areas of money, credit, finance, production, etc.,

ii. Collects statistics about the various sectors of the economy and publishes them,

iii. Gives advice to the government for the solution of various economic problems and in the formulation of its economic and financial policies.

11. **Department of Planning and Reorganization**: The department formulates new plans and policies. It also reorganizes existing ones in order to make them more effective.

12. **Economic Department**: This department formulates banking policies for better implementation of economic policies of the Government.

13. **Inspection Department**: This department undertakes inspection of various offices of the commercial banks.

14. **Department of Accounts and Expenditure**: This department maintains proper records of all receipts and expenditures of the Reserve Bank of India.

15. **RBI Services Board**: This Board deals with the selection of new employees for different posts in the Reserve Bank of India.

16. **Department of Supervision**: This department was set up for conducting proper supervision of commercial banks.

Reserve Bank and Industrial Finance

For promoting industrialization, the Reserve Bank has been providing finance through various institutions, to large, medium and small-scale industries. For this purpose it has helped in establishment of a number of financial institutions at the centre as well as in States and provides credit facilities to them. These institutions are:

1. Industrial Finance Corporation of India
2. National Industrial Credit (Long Term Operations) Funds
3. Industrial Development Bank of India (IDBI)
4. Industrial Credit and Investment Corporation of India (ICICI)
5. Industrial Reconstruction Bank of India (IRBI)
6. State Financial Corporation (SFCs)
7. Small Industries Development Bank of India (SIDBI)
8. Exim Bank
9. National Housing Bank (NHB)

The RBI has set many other institutions also in the category of industrial development banks. They are discussed in detail in the chapter "Development Banking".

Differences between Central Bank and Other Banks

The Central Bank differs from other financial institutions.

Firstly, the people who are more or less closely connected with other organs of government control it.

Second, it does not exist to secure the maximum profit, which is the principal aim of a commercial bank.

Third, the Central Bank must have a special relation with the commercial banks whereby it can influence the functioning and operations of these institutions in the implementation of the government's economic policy.

Fourth, the functions of the Central Bank and the obligations resting upon it are of a very special character, calling for skill, experience and judgment of a kind different from those required from a commercial bank.

Thus, the Central Bank is an organ of the government, which influences the working of financial institutions of the country.

Nature and Functions of Central Bank

The Central Bank is the apex monetary institution in the money market. It acts as the monetary authority of the country, and serves as the government bank as well as the bankers' bank. It undertakes the major financial operations of the government. It influences the behaviour of financial institutions to ensure that they support the economic policy of government.

The main function of the Central Bank is to regulate the monetary mechanism comprising of the currency, banking and credit systems. For this purpose, the bank is given wide powers. Another important function of the central bank is to conduct the banking and financial operations of the government. Besides, it discharges certain other functions. These functions are performed with the service motive and not for making profits.

The Central Bank must have a special relation with the commercial banks whereby it can influence the functioning and operations of these institutions in the implementation of the government's economic policy.

Traditional Central Banking Functions (monetary functions)

Bank of Issue – The Minimum Reserve System

1. The Reserve Bank has a separate Issue Department, which is entrusted with the issue of currency notes. The assets and liabilities of the Issue Department are kept separate from those of the Banking department.

2. Under Section 22 of the Reserve Bank of India Act, the Bank has the sole right to issue bank notes of all denominations.

3. The Government of India makes one rupee notes and coins and small coins and the RBI on its behalf, distributes them all over the country as agent of the government.

4. Originally, the assets of the Issue Department consisted of not less than two-fifths of gold coin, gold bullion or securities provided the amount of gold was not less than Rs. 40 crores in value.

5. The remaining three-fifths of the assets might be in form of rupee coins, Government of India rupee securities, eligible bills of exchange and promissory notes payable in India.
6. Due to the emergencies of the Second World War and the post-war period, these provisions were considerably modified.
7. Since 1957, the Reserve Bank of India is required to maintain gold and foreign exchange reserves of Rs. 200 crores, of which at least Rs. 115 crores should be in gold. The system as it exists today is known as the minimum reserve system.

Banker to Government

Reserve Bank of India acts as Government banker, agent and adviser.

1. The Reserve Bank is the agent of the Central Government and of all state governments in India, excepting that of Jammu and Kashmir.
2. The Reserve Bank has the obligation to transact government business, to keep the cash balances as deposits free of interest, to receive and to make payments on behalf of the government
3. Carry out government exchange remittances and other banking operations.
4. The Reserve Bank of India helps the government – both the Union and the states to float new loans and to manage public debt.
5. It makes ways and means advances (WMA) to the governments for 90 days.
6. It makes loans and advances to the States and local authorities.
7. It acts as adviser to the government on all monetary and banking matters.

Bankers' Bank and Lender of the Last Resort

The Reserve Bank of India acts as the bankers' bank:

According to the provisions of the Banking Companies Act of 1949, every scheduled bank was required to maintain with the Reserve Bank a cash balance equivalent to 5% of its demand liabilities and 2 per cent of its time liabilities in India. By an amendment of 1962, the distinction between demand and time liabilities was abolished and banks have been asked to keep cash reserves equal to 3 per cent of their aggregate deposit liabilities. The Reserve Bank of India can change the minimum cash requirements.

Commercial banks can always expect the Reserve Bank of India to come to their help in times of banking crisis the Reserve Bank becomes not only the banker's bank but also the lender of the last resort.

i. The scheduled banks can borrow from the Reserve Bank of India on the basis of eligible securities.

ii. Can get financial accommodation in times of need or strictness by rediscounting bills of exchange.

Caution Since 1957, the Reserve Bank of India is required to maintain gold and foreign exchange reserves of Rs. 200 crores, of which at least Rs. 115 crores should be in gold. The system as it exists today is known as the minimum reserve system.

Controller of Credit

The Reserve Bank of India is the controller of credit:

1. It has the power to influence the volume of credit created by banks in India by changing the Bank rate or through open market operations.
2. According to the Banking Regulation Act of 1949, the Reserve Bank of India can ask any particular bank or the whole banking system not to lend to particular groups or persons on the basis of certain types of securities.
3. Since 1956, selective controls of credit are increasingly being used by the Reserve Bank.
4. Every bank has to get a license from the Reserve Bank of India to do banking business within India.
5. The license can be cancelled by the Reserve Bank of certain stipulated conditions are not fulfilled. Every bank will have to get the permission of the Reserve Bank before it can open a new branch.
6. Each scheduled bank must send a weekly return to the Reserve Bank showing, in detail, its assets and liabilities.
7. The Reserve Bank has also the power to inspect the accounts of any commercial bank.

These powers of the Bank to call for information are also intended to give it effective control of the credit system.

Custodian of Foreign Reserves

1. The Reserve Bank of India has the responsibility to maintain the official rate of exchange.
2. According to the Reserve Bank of India Act of 1934, the Bank was required to buy and sell at fixed rates any amount of sterling in lots of not less than Rs. 10,000. The rate of exchange fixed was Re. 1 = sh. 6d. Since 1935 the Bank was able to maintain the exchange rate fixed at 1sh.6d. Though there were periods of extreme pressure in favour of or against the rupee.
3. After India became a member of the International Monetary Fund in 1946, the Reserve Bank has the responsibility of maintaining fixed exchange rates with all other member countries of the IMF.
4. The Reserve Bank has to act as the custodian of India's reserve of international currencies

   i.e. forex balances are acquired and managed by the Bank.

5. The RBI has the responsibility of administering the exchange controls of the country.

Notes Thus, as a supreme banking authority in the country, the Reserve Bank of India, therefore, has the following powers:

1. It holds the cash reserves of all the scheduled banks.
2. It controls the credit operations of banks through quantitative and qualitative controls.
3. It controls the banking system through the system of licensing, inspection and calling for information.
4. It acts as the lender of the last resort by providing rediscount facilities to scheduled banks.
5. Controller of Forex reserves of the country.

In addition to its traditional central banking functions, the Reserve bank has certain non-monetary functions of the nature of supervision of banks and promotion of sound banking in India.

According to the Banking Regulation Act of 1949, the Reserve Bank of India can ask any particular bank or the whole banking system not to lend to particular groups or persons on the basis of certain types of securities.

Supervisory Functions (Non-monetary Functions)

1. The Reserve Bank Act, 1934, and the Banking Regulation Act, 1949 have given the RBI wide powers.
2. RBI has to supervise and control commercial and cooperative banks in relation to licensing and establishments, branch expansion, liquidity of their assets, management and methods of working, amalgamation, reconstruction, and liquidation.
3. The RBI is authorized to carry out periodical inspections of the banks and to call for returns and necessary information from them.
4. The nationalization of 14 major Indian scheduled banks in July 1969 imposed new responsibilities on the RBI for directing the growth of banking and credit policies towards more rapid development of the economy and realisation of certain desired social objectives.

The supervisory functions of the RBI have helped a great deal in improving the standard of banking in India to develop on sound lines and to improve the methods of their operation.

Promotional Functions (Non-monetary Functions)

Since independence, with economic growth, the range of the Reserve Bank’s functions has steadily widened. The Bank now performs a variety of developmental and promotional functions, which, at one time, were regarded as outside the normal scope of central banking.

1. The Reserve Bank promotes banking habits
2. extends banking facilities to rural and semi-urban areas

3. Establishes and promotes new specialised financing agencies i.e., Industrial Development Banks

4. Development of the cooperative credit movement to encourage savings and to eliminate moneylenders from the villages and to route its short-term credit to agriculture e.g. Agricultural Refinance and Development Corporation to provide long-term finance to farmers.

Miscellaneous Functions

1. Interest Rate Interventions:

The most visible and obvious power of many modern central banks is to influence market interest rates; contrary to popular belief, they rarely "set" rates to a fixed number. Typically, a central bank controls certain types of short-term interest rates. These influence the stock and bond markets as well as mortgage and other interest rates.

The mechanism to move the market towards a 'target rate' (whichever specific rate is used) is generally to lend money or borrow money in theoretically unlimited quantities, until the targeted market rate is sufficiently close to the target. Central banks may do so by lending money to and borrowing money from (taking deposits from) a limited number of qualified banks, or by purchasing and selling bonds.

2. Monetary Policy Instruments:

The main monetary policy instruments available to central banks are open market operation, bank reserve requirement, interest-rate policy, re- lending and rediscount (including using the term repurchase market), and credit policy (often coordinated with trade policy).

To enable open market operations, a central bank must hold foreign exchange reserves (usually in the form of government bonds) and official gold reserves. It will often have some influence over any official or mandated exchange rates. Some exchange rates are managed, some are market based (free float) and many are somewhere in between ("managed float" or "dirty float").

Through open market operations, a central bank influences the money supply in an economy directly. Each time it buys securities, exchanging money for the security, it raises the money supply. Opposite to this, selling of securities lowers the money supply. Buying of securities thus amounts to printing new money while lowering supply of the specific security.

The main open market operations are:

i. Temporary lending of money for collateral securities ("Reverse Operations" or "repurchase operations", otherwise known as the "repo" market). These operations are carried out on a regular basis, where fixed maturity loans (of 1 week and 1 month for the ECB) are auctioned off.

ii. Buying or selling securities ("Direct Operations") as per need.

iii. Foreign exchange operations such as forex swaps.

All of these interventions can also influence the foreign exchange market and thus, the exchange rate.

Capital requirements – Capital Adequacy

All banks are required to hold a certain percentage of their assets as capital, a rate which may be established by the central bank or the banking supervisor. Partly due to concerns about asset inflation and term repurchase agreements, capital requirements may be considered more effective than deposit/reserve requirements in preventing indefinite lending: when at the threshold, a bank cannot extend another loan without acquiring further capital on its balance sheet.

Reserve Requirements (CRR, SLR)

Another significant power that central banks hold is the ability to establish reserve requirements for other banks. By requiring that a percentage of liabilities be held as cash or deposited with the central bank (or other agency), limits are set on the money supply.

In practice, many banks are required to hold a percentage of their deposits as reserves. Such legal reserve requirements were introduced in the nineteenth century to reduce the risk of banks overextending themselves and suffering from bank runs, as this could lead to knock-on effects on other banks. Even if reserves were not a legal requirement, prudence would ensure that banks would hold a certain percentage of their assets in the form of cash reserves.

Cash Reserve Ratio (CRR)

The present banking system is called a “fractional reserve banking system”, as the banks are required to keep only a fraction of their deposit liabilities in the form of liquid cash with the central bank to ensure safety and liquidity of deposits.

The Cash Reserve Ratio (CRR) refers to this liquid cash that banks have to maintain with the Reserve Bank of India (RBI) as a certain percentage of their demand and time liabilities.

Example: If the CRR is 10% then a bank with net demand and time deposits of Rs 1,00,000 will have to deposit Rs 10,000 with the RBI as liquid cash.

The CRR is applicable to all scheduled banks including the scheduled cooperative banks and the Regional Rural Banks (RRBs).

At present, the RBI does not pay any interest to the banks on the CRR deposits. Prior to 1962, a separate CRR was fixed in respect of demand and time liabilities. However, after 1962, the separate CRRs were merged and one CRR came into effect for both demand and time deposits of banks with the RBI.

CRR–A tool of credit control

CRR was introduced in 1950 chiefly as a measure to guarantee safety and liquidity of bank deposits. However over the years it has become an important and effective tool for directly regulating the lending capacity of banks and controlling the money supply in the economy. When the RBI feels that the money supply is increasing and causing an upward pressure on inflation, the

RBI has the option of increasing the CRR thereby reducing the deposits available with banks to make loans and hence reducing the money supply and inflation and vice versa.

The RBI has the authority to impose penal interest rates on the banks in respect of their shortfalls in the prescribed CRR. In fact, if the default continues on a basis RBI can even cancel the bank's license or force it to merge with a larger bank.

Statutory Liquidity Ratio (SLR)

Statutory Liquidity Ratio or SLR refers to the amount that all banks require to maintain in cash or in the form of gold or approved securities. Approved securities mean bond and shares of different companies. Thus, Statutory Liquidity Ratio is determined as percentage of total demand and percentage of time liabilities.

The money deposited by commercial banks at the central bank is the real money in the banking system; other versions of what is commonly thought of as money are merely promises to pay real money. These promises to pay are circulatory multiples of real money. For general purposes, people perceive money as the amount shown in financial transactions or amount shown in their bank accounts. But bank accounts record both credit and debits that cancel each other. Only the remaining central-bank money after aggregate settlement – final money – can take one of two forms:

1. Physical cash, which is rarely used in wholesale financial markets
2. central-bank money.

The currency component of the money supply is far smaller than the deposit component. Currency and bank reserves together make up the monetary base, called M1 and M2.

Exchange Requirements

To influence the money supply, some central banks may require that some or all foreign exchange receipts (generally from exports) be exchanged for the local currency. The rate that is used to purchase local currency may be market-based or randomly set by the bank. This tool is generally used in countries with non-convertible currencies or partially-convertible currencies.

The recipient of the local currency may be allowed to freely dispose of the funds, required to hold the funds with the central bank for some period of time, or allowed to use the funds subject to certain restrictions. In other cases, the ability to hold or use the foreign exchange may be otherwise limited.

In this method, money supply is increased by the central bank when it purchases the foreign currency by issuing (selling) the local currency. The central bank may subsequently reduce the money supply by various means, including selling bonds or foreign exchange interventions.

Selective Credit Control

The Banking Regulation Act confers wide powers on the Reserve Bank of India to control the level and pattern of banks' advances in general or on a selective basis. Under Section 21 of the banking Regulation Act, 1949, the Reserve Bank is empowered to issue directions to the banking companies to determine the policy in relation to advances to be followed by them either generally or by any of them in particular. The Reserve Bank's directives may relate to any/or of the following:

1. The purposes for which advances may or may not be made.

2. The margins to be maintained in respect of secured advances.

3. The maximum amount of advances to any company, firm, individual etc.

4. The rate of interest and other terms and conditions on which advances and other financial accommodation may be given.

The Reserve Bank of India has been operating selective controls since 1956 in respect of certain commodities, which have been sensitive or in short supply. These controls are being enforced with the objective to discourage the use of bank finance for the hoarding of such commodities so as to check an unjustified rise in their prices.

Advances against (1) Food grains, (2) Pulses, (3) Oilseeds, (4) Vegetable oils, (5) Cotton and Kapas and (6) Sugar, Gur and Khandsari have been covered by selective credit controls.

Techniques of Selective Credit Controls

Three instruments of selective credit controls are discussed below:

Fixation of party wise ceiling on credit: The ceilings are fixed keeping in view the crop prospects, supply position and price trends. After the fixation of ceiling of credit on a party wise basis since November 1972, banks are required to seek the prior permission of the Reserve Bank for (1) granting loans to new borrowers, and (2) increasing the credit limits in case of existing borrowers. Thus, one bank cannot take over a commodity account, which is subject to credit control from another bank without seeking prior approval of the Reserve Bank.

Imposition of minimum margin: In case of advances against commodities subject to selective control, higher margins are prescribed in order to restrict the borrowing capacity of the borrowers. With higher margin, a borrower can get less credit from banks against a certain quantity of stock and thus can finance only a smaller part of it through bank finance. Moreover, different margins may be prescribed for different types of borrowers against the security of the same commodity. A higher margin is generally for those borrowers whose need for credit is not so urgent or larger flow of credit to whom is likely to aggravate the price situation.

Example: Minimum margins were prescribed for advances against food grains, pulses and oilseeds (w.e.f 19th October, 1987) at 45% for processing units/mills and against warehouse receipts and at 60% for others.

Fixation of minimum lending rate: Though the Reserve Bank had prescribed the interest rates on various categories of commercial bank advances which include the maximum rates of interest to be charged in certain cases, the minimum lending rate was prescribed for advances for commodities subject to selective control.

In order to make selective credit controls more successful, clean credit facilities are not allowed to any borrower affected by selective credit controls. Appropriate exemptions from the requirements of the selective credit controls are, however, granted so as to avoid unnecessary hardship to the deserving borrowers.

Example: Advances granted to certain categories of borrowers e.g. state agencies like the Food Corporation of India and State Trading Corporation are exempted from the application of the directives. Exports are exempted from the purview of selective controls.

These restrictions are generally less severe in respect of credit granted to the manufacturing and processing units and are tighter in case of traders. Similarly, advance against the security of or by way of purchase of demand documentary bills drawn in connection with the movement of goods subject to selective controls are exempted, while usance bills are not.

Risk Management and Central Bank

The survey of central bank risk managers confirms that a high proportion of central banks is currently restructuring their risk management operations. This survey reveals:

1. Increasing integration of risk management;
2. Recognition of the importance of operational risk;
3. A need for clear objectives for the various departments involved in risk management.

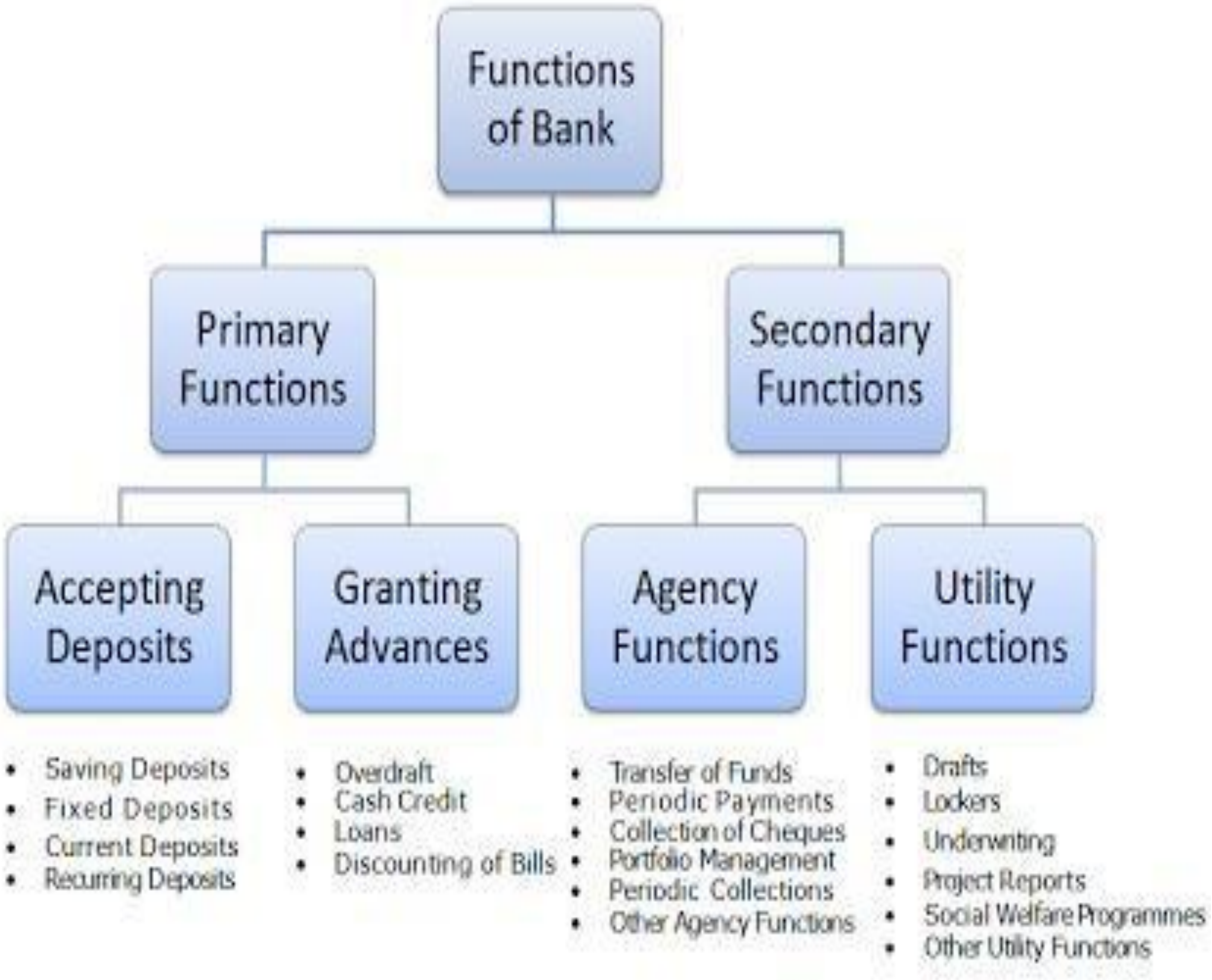
Central banks need to interpret the concept of risk in a very broad sense. Risk includes not only the identification and control of financial market risks and payment systems risks, but also reputation risks, political risks, regulatory risks, technological risks and moral hazards. Thus:

1. The key tasks of all central banks – monetary and exchange rate policy, oversight of payment systems, supervision, and crisis management – all require central banks to manage risk.
2. Central bankers need to identify and manage political and reputation risks.
3. Organize a risk management department so that it can work effectively with the internal audit department, the external auditors and the financial control department.
4. Larger central banks are leading the way in developing risk management procedures and translating this into corporate governance in the central bank.
5. For smaller banks with limited resources, setting up a separate risk management department is often not feasible. In these circumstances, risk has to be assessed and controlled by departmental heads.
6. Rising "risk awareness" is widely recognized as an important step to reducing operational risk for the organization as a whole.

In nutshell, a risk identification and management culture has to be developed in a central bank.

Functions of a Bank

Banks' functions can be segregated into Primary and Secondary functions as follows:



A. Primary Functions: There are two primary functions of a commercial bank as given in Banking Regulations Act, 1949.

a. Accepting deposits of money from the public in the form of

- Savings accounts
- Current accounts
- Fixed deposits
- Recurring deposits

These deposits are withdrawable by cheque order or otherwise

Advancing Loans: The other important function of the banks is to make loans and advances to the needy people in the form of:

- Over drafts
- Cash credits

- Term loans
- Discounting of bills
- Credit Cards loan

Banks are also permitted to invest their funds in securities which may be Government securities or corporate securities

The Secondary Functions of a Bank

Transfer of funds: Helps customers to transfer money to another customer of the same bank or of any other bank in the same country or even in another foreign country.

Agency services provided by Commercial Banks:

Purchasing and selling of shares, securities, bonds etc. on behalf of its customers

Collection and regular payments of bills, checks and other commercial instruments, dividends, interest etc. as per the standing instructions given by their customers.

Collection and payment of rents, insurance premium and other charges. Providing consultancy services regarding shares, taxation etc. to the companies.

Lending advice as a Merchant Banker to industries about their new projects, issue of shares and capital structure etc.

Relationship between Banker and Customer

The relationship between the banker and customer is very important. It is generally studied under the following two heads:

- Basic Relationship
- Special Relationship

Basic Relationship:

Debtor and Creditor: The basic relationship between banker and customer is primarily that of a debtor and creditor. When a customer deposits money with a bank, Bank becomes the debtor and Customer the creditor. It will be returned to him on demand or as the specified period of tenure within business hours. The money will be remain safe and will earn interest

Creditor and Debtor: The position is reversed if the customer is advanced a loan by the Bank. Banker becomes creditor and Customer is debtor.

Special Relationships

Bailer and Bailee relationship:

- Bailment is a contract for delivering goods by one party to another to be held in trust for a specific period and returned back to him when the purpose is over.

- Bailer is the party that delivers the goods.

- Bailee is the party to whom the goods are delivered

So, when a customer gives a sealed box to the bank for safe custody, the customer becomes the Bailer, and the bank becomes the Bailee. A bank may accept the valuables of his customer such as jewelry, documents, and securities for safe custody.

Agent - Principal: Banker acts as agent of the customer for various purposes such as

Customer (principal) deposits with Banks, cheques, drafts, dividends warrants for collection.

He also gives written instructions to the bank to purchase securities, pay insurance premium, installments of loans etc. on his behalf

Lessor and Lessee: When the banker hires a safe deposit locker to the customer. Banker becomes the Lessor, and Customer will become the Lessee.

Trustee and Beneficiary: A trustee holds property on behalf of the beneficiary, and the income earned from the property belongs to the beneficiary. If the customer creates a Trust and appoints the bank as Trustee, the bank administers the property for the benefit of the beneficiary named in the Trust Deed.

Other Relationships:

Pledger and Pledge: A customer pledges certain goods (assets) or securities with the bank in order to get a loan. In this case, Customer becomes the Pledger, and Bank becomes the Pledgee.

Hypothecator and Hypothecate: When the customer gives certain movable assets to the banker in order to get a loan, Customer becomes the Hypothecator, and Banker becomes the Hypothecate.

Advisor and Client: When a customer invests in securities on the advice of his bank, the banker acts as an advisor.

The banking system in India is significantly different from that of other Asian nations because of the country's unique geographic, social, and economic characteristics. India has a large population and land size, a diverse culture and extreme disparities in income, which are marked among its regions. There are high levels of illiteracy among a large percentage of its population but, at the same time, the country has a large reservoir of managerial and technologically advanced talents. Between about 30 and 35 percent of the population resides in metro and urban cities and the rest is spread in several semi-urban and rural centers. The country's economic policy framework combines socialistic and capitalistic features with a heavy bias towards public sector investment. India has followed the path of growth-led exports rather than the "export led growth" of other Asian economies, with emphasis on self-reliance through import substitution. These features are reflected in the structure, size, and diversity of the country's banking and financial sector. The banking system has had to serve the goals of economic policies enunciated in successive five year development plans, particularly concerning equitable income distribution, balanced regional economic growth, and the reduction and elimination of private sector monopolies in trade and industry. In order for the banking industry to serve as an instrument of state policy, it was subjected to various nationalization schemes in different phases (1955, 1969, and 1980). As a result, banking remained internationally isolated (few Indian banks had presence abroad in international financial centers) because of preoccupations with domestic priorities, especially massive branch expansion and attracting more people to the system. Moreover, the sector has been assigned the role of providing support to other economic sectors such as agriculture, small-scale industries, exports, and banking activities in the developed commercial centers (i.e., metro, urban, and a limited number of semi-urban centers). The banking system's international isolation was also due to strict branch licensing controls on foreign banks already operating in the country as well as entry restrictions facing new foreign banks. A criterion of reciprocity is required for any Indian bank to open an office abroad. These features have left the Indian banking sector with weaknesses and strengths. A big challenge facing Indian banks is how, under the current ownership structure, to attain operational efficiency suitable for modern financial intermediation. On the other hand, it has been relatively easy for the public sector banks to recapitalize, given the increases in nonperforming assets (NPAs), as their Government dominated ownership structure has reduced the conflicts of interest that private banks would face.

The banking industry in India is undergoing a major transformation due to changes in economic conditions and continuous deregulation. These multiple changes happening one after other has a ripple effect on a bank trying to graduate from completely regulated seller market to completed deregulated customers market. So that's why the Indian banking sector is facing following challenges:

Deregulation: This continuous deregulation has made the Banking market extremely competitive with greater autonomy, operational flexibility and decontrolled interest rate and liberalized norms for foreign exchange. The deregulation of the industry coupled with decontrol in interest rates has led to entry of a number of players in the banking industry. At the same time reduced corporate credit off take thanks to sluggish economy has resulted in large number of competitors batting for the same pie.

New rules: As a result, the market place has been redefined with new rules of the game. Banks are transforming to universal banking, adding new channels with lucrative pricing and freebees to offer. Natural fall out of this has led to a series of innovative product offerings catering to various customer segments, specifically retail credit.

Efficiency: This in turn has made it necessary to look for efficiencies in the business. Banks need to access low cost funds and simultaneously improve the efficiency. The banks are facing pricing pressure, squeeze on spread and have to give thrust on retail assets.

Diffused Customer loyalty: This will definitely impact Customer preferences, as they are bound to react to the value added offerings. Customers have become demanding and the loyalties are diffused. There are multiple choices, the wallet share is reduced per bank with demand on flexibility and customization. Given the relatively low switching costs; customer retention calls for customized service and hassle free, flawless service delivery.

Misaligned mindset: These changes are creating challenges, as employees are made to adapt to changing conditions. There is resistance to change from employees and the Seller market mindset is yet to be changed coupled with Fear of uncertainty and Control orientation. Acceptance of technology is slowly creeping in but the utilization is not maximized.

Competency Gap: Placing the right skill at the right place will determine success. The competency gap needs to be addressed simultaneously otherwise there will be missed opportunities. The focus of people will be on doing work but not providing solutions, on escalating problems rather than solving them and on disposing customers instead of using the opportunity to cross sell.

Other Challenges: Beside the above said challenges Indian banking sector is facing some other challenges too:

- Implementation of Basel II
- Implementation of latest technology
- How to reduce NPA
- Corporate governance
- Man power planning
- Talent management
- Loan waiver: A new challenge
- Risk management
- Transparency and disclosures
- Challenges in banking security
- Growth in business
- Enhancing customer service

- Financial Inclusion
- Coping up with new IFRS

Non-Performing Assets in Indian Banks

Non-performing Asset (NPA) has emerged since over a decade as an alarming threat to the banking industry in our country sending distressing signals on the sustainability and endurability of the affected banks. The positive results of the chain of measures affected under banking reforms by the Government of India and RBI in terms of the two Narasimhan Committee Reports in this contemporary period have been neutralized by the ill effects of this surging threat. Despite various correctional steps administered to solve and end this problem, concrete results are eluding. It is a sweeping and all pervasive virus confronted universally on banking and financial institutions. The severity of the problem is however acutely suffered by Nationalized Banks, followed by the SBI group, and the all India Financial Institutions.

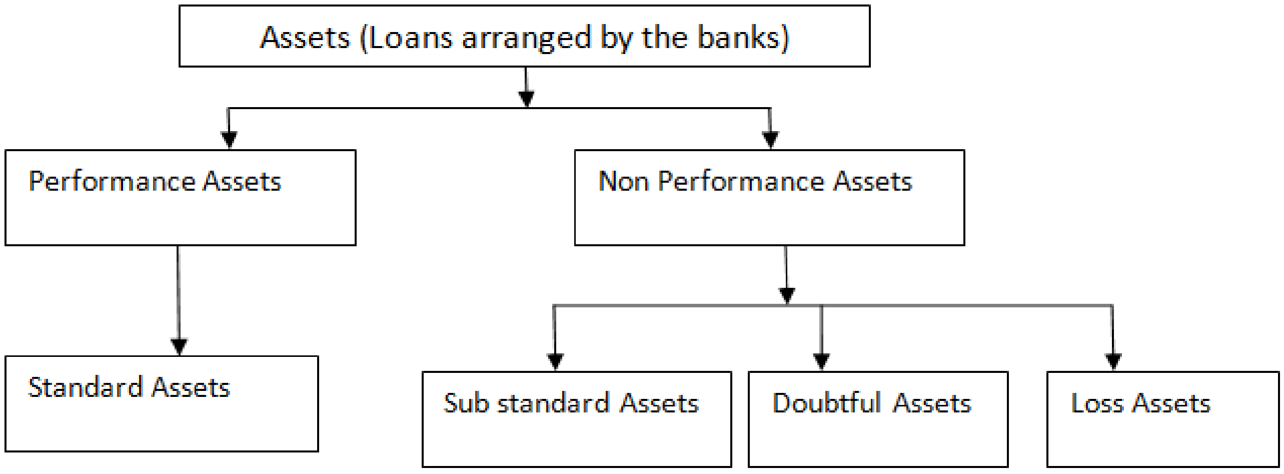
An asset is classified as Non-performing Asset (NPA) if due in the form of principal and interest are not paid by the borrower for a period of 180 days. However with effect from March 2004, default status would be given to a borrower if dues are not paid for 90 days. If any advance or credit facilities granted by banks to a borrower becomes non-performing, then the bank will have to treat all the advances/credit facilities granted to that borrower as non-performing without having any regard to the fact that there may still exist certain advances / credit facilities having performing status.

Though the term NPA connotes a financial asset of a commercial bank, which has stopped earning an expected reasonable return, it is also a reflection of the productivity of the unit, firm, concern, industry and nation where that asset is idling. Viewed with this perspective, the NPA is a result of an environment that prevents it from performing up to expected levels.
The definition of NPAs in Indian context is certainly more liberal with two quarters norm being applied for classification of such assets. The RBI is moving over to one-quarter norm from 2004 onwards.

After arranging the required loans by following structural procedural methods, debtor will be expected to repay the loan in the following ways

1. Regular EMIs (Equated Monthly Instalments) which includes both Principle and Interest
2. Repayment of Interest at regular time intervals and at the end of maturity period Principle amount payment
3. Repayment of both Interest and Principle amount at the end of the maturity period, especially for Agricultural loans this type of repayment mode applies by the banks
4. In the case of special category loans and credit cards no interest expects by the banks except the principle amount with in stipulated time period. If that time period exceeds charges interest on such loans.

Based on the above repayment mode the Assets of the bank are categorises as Performance and Non Performance Assets.



Performance Asset: If there is no problem contains in repayment mode of assets such assets are called as performance assets.

Standard Asset: Even if any problem contains in repayment mode and that problem can solvable within 90 days of due date then those assets is called as Standard assets.

Non Performing Asset:

The asset that seizes the profitability of the banks is called Non Performing Asset. The assets which are due for more than 90 days are called as Non-performing assets.

Sub Standard Asset: An NPA continued for more than one year is called Sub Standard asset.

Doubtful Asset: A Sub standard Assets continues as an NPA more than one more year is called Doubtful Asset. At this stage bank will start to maintain provisions against NPA as per the guidelines of RBI.

Loss Asset: If the details of the bank's debtor is loss by the banks and no hope of recovering the assets by any means is called Loss Asset

Tools introduced by Reserve Bank of India related to NPAs:

Nonperforming assets are a drain to the banks. The banks in India are adopting various strategies to reduce the non performing assets in their banks and they are also adopting various methodologies by which further addition to NPA portfolio is minimized

For recovery of NPA there are different tools are available. The important purpose of these tools is to recover the loan amount from borrower. These tools can be use according to Loan amount.

Following are the different recovery tools.

1. LOK ADALATS
2. DEBT RECOVERY TRIBUNALS (DRT)
3. SARFAESI ACT, 2002
4. ASSET RECOVERY CONSTRUCTION INDUSTRY LIMITED(ARCIL)
5. CORPORATE DEBT RESTRUCTURING (CDR)
6. ASSET MANAGEMENT COMPANY(AMC)
7. RECOVERY CAMPS
8. PREFERENCE OF CLAIMS
9. COMPROMISE PROPOSALS
10. TECHNICAL WRITE OFF
11. ONE TIME SETTLEMENT SCHEME
12. SUIT FILING

1. Lok Adalats :

Lok Adalats is a mechanism to settle matters relating to recovery of dues, out of court. These are convened by Debt Recovery Tribunals / Debt Recovery Appellate Tribunals. Lok Adalats have no judicial powers. It is a mutual forum for the bank and the borrower to meet and arrive at a mutual settlement. Once the settlement is signed by both the parties, the same is placed before the court. The court would then pass a suitable decrees / orders as per the terms of settlement. Such decrees cannot be challenged in the next higher courts. At present, accounts in doubtful and loss category with outstanding above Rs. 5.00 lacs can be referred to this forum. Lok Adalats Proved to be quite effective for speedy justice and recovery of small loans.

2. DEBT RECOVERY TRIBUNALS (DRT)

Keeping in line with the international trends on helping financial institutions recover their bad debts quickly and efficiently, the Government of India has constituted thirty three Debts Recovery Tribunals and five Debts Recovery Appellate Tribunals across the country.

The Debts Recovery Tribunal (DRT) enforces provisions of the Recovery of Debts Due to Banks and Financial Institutions (RDDBFI) Act, 1993 and also Securitization and Reconstruction of Financial Assets and Enforcement of Security Interests (SARFAESI) Act, 2002.

Under the Recovery of Debts Due to Banks and Financial Institutions (RDDBFI) Act, 1993 banks approach the Debts Recovery Tribunal (DRT) whereas, under Securitization and Reconstruction of Financial Assets and Enforcement of Security Interests (SARFAESI) Act, 2002 borrowers, guarantors, and other any other person aggrieved by any action of the bank can approach the Debts Recovery Tribunal (DRT).

Debts Recovery Tribunal are located across the country. Some cities have more than one Debts Recovery Tribunals. New Delhi, Chennai, Kolkata and Mumbai have three Debts Recovery Tribunals. Ahmedabad and Chandigarh have two Debts Recovery Tribunal (DRT) each. One Debts Recovery Tribunal has been constituted at Allahabad, Aurangabad, Bangalore, Coimbatore, Cuttack, Earnakulam, Guwahati, Hyderabad, Jabalpur, Jaipur, Lucknow, Madurai,Nagpur, Patna, Pune, Vishakapatnam and Ranchi.

3. SARFAESI ACT, 2002

The full form of SARFAESI Act as we know is Securitisation and Reconstruction of Financial Assets and Enforcement of Security Interest Act, 2002. Banks utilize this act as an effective tool for bad loans (NPA) recovery. It is possible where non-performing assets are backed by securities charged to the Bank by way of hypothecation or mortgage or assignment.

SARFAESI is effective only for secured loans where bank can enforce the underlying security eg hypothecation, pledge and mortgages. In such cases, court intervention is not necessary, unless the security is invalid or fraudulent. However, if the asset in question is an unsecured asset, the bank would have to move the court to file civil case against the defaulters.

4. ASSET RECOVERY CONSTRUCTION INDUSTRY LIMITED (ARCIL)

The word asset reconstruction company is a typical used in India. Globally the equivalent phrase used is "asset management companies". The word "asset reconstruction" in India was used in Narsimham I report where it was envisaged for the setting up of a central Asset Reconstruction Fund with money contributed by the Central Government, which was to be used by banks to shore up their balance sheets to clean up their non-performing loans. However, this never saw the light of the day and later on Narsimham II floated the idea asset reconstruction companies..

Why ARC :

In last 15 years or so the a number of economies around the world have witnessed the problem of nonperforming assets. A high level of NPAs in the banking system can severely affect the economy in many ways. The high level of NPAs leads to diversion of banking resources towards resolution of this problems. This causes an opportunity loss for more productive use of resources. The banks tend to become risk averse in making new loans, particularly to small and medium sized companies. Thus, large scale NPAs when left unattended, cause continued economic and financial degradation of the country. The realization of these problems has lead to greater attention to resolve the NPAs. ARCs have been used world-wide, particularly in Asia, to resolve bad-loan problems. However, these had a varying degree of success in different countries. ARCs focus on NPAs and allows the banking system to act as "clean bank".

ARC in India:

In India the problem of recovery from NPAs was recognized in 1997 by Government of India. The Narasimhan Committee Report mentioned that an important aspect of the continuing reform process was to reduce the high level of NPAs as a means of banking sector reform. It was expected that with a combination of policy and institutional development, new NPAs in future could be lower. However, the huge backlog of existing NPAs continued to hound the banking sector. It impinged severely on banks performance and their profitability. The Report envisaged creation of an "Asset Recovery Fund" to take the NPAs off the lender's books at a discount.

Accordingly, Asset Reconstruction Company (Securitization Company / Reconstruction Company) is a company registered under Section 3 of the Securitisation and Reconstruction of Financial Assets and Enforcement of Security Interest (SRFAESI) Act, 2002. It is regulated by Reserve Bank of India as an Non Banking Financial Company (u/s 45I (f) (iii) of RBI Act, 1934).

RBI has exempted ARCs from the compliances under section 45-IA, 45-IB and 45-IC of the Reserve Bank Act, 1934. ARC functions like an AMC within the guidelines issued by RBI.

ARC has been set up to provide a focused approach to Non-Performing Loans resolution issue by:-

(a) Isolating Non Performing Loans (NPLs) from the Financial System (FS),

(b) Freeing the financial system to focus on their core activities and

(c) Facilitating development of market for distressed assets.

5. CORPORATE DEBT RESTRUCTURING (CDR)

Corporate debt restructuring is the reorganization of a company's outstanding obligations, often achieved by reducing the burden of the debts on the company by decreasing the rates paid and increasing the time the company has to pay the obligation back.

6. ASSET MANAGEMENT COMPANY (AMC)

An asset management company (AMC) is a company that invests its clients' pooled funds into securities that match declared financial objectives. Asset management companies provide investors with more diversification and investing options than they would have by themselves. In the real sense, in case there is a recovery in principal and instalments due in respect of the loans granted to the banks are received 100%, the question of nonperforming assets do not arise. However, there is no such ideal bank where the NPA is nil. Except banks which were originated recently, all banks are prone to have some portion of their loans and advances as non performing advances

7. RECOVERY CAMPS:

Bank personnel jointly approach the defaulting borrowers for repayment at a place and time convenient to both the parties. These are more suited to small loans. Normally the borrowers who had availed small loans will be more in number in rural and semi urban areas rather than urban and metro centres. As such, the banks instead of conducting the recovery camps at their branches, they usually conduct such recovery camps in centres like panchayat board offices, court buildings, government department buildings etc such recovery camps so that the borrowers find it convenient to attend the recovery camps. Under certain circumstances, the manager in charge of the bank branches along with some branch officials go to each visit each house of the borrowers and recover the instalments due in respect of loans availed by them. This type of recovery camp will be successful in case an advance notice is served on the borrowers mentioning the date of recovery camps

8. PREFERENCE OF CLAIMS:

Banks should expeditiously and properly claim indemnity from organizations like Deposit Insurance and Credit Guarantee Corporation called DICGC, Export Credit Guarantee Corporation called ECGC, Credit Guarantee Fund Trust for small scale industries, Insurance Companies etc and invoke Government/other personal guarantees to recover loan dues and reduce nonperforming assets.

9. COMPROMISE PROPOSALS:

Compromise routes are adopted by banks, where borrowers experience certain genuine difficulties and where normal recovery is not possible. It involves certain sacrifices on the part of the banks on the principle of “one bird at hand is worth two in the bush”. Such proposals can be taken up considering the history of the borrowable account, security available, net worth of the borrower/guarantor, time value of offer made etc

10. TECHNICAL WRITES OFF:

Normally banks decide writing off small loans which have become bad and the recovery is not at all possible in those accounts under any circumstances on account of the facts that the borrower might have been expired; he has no means to repay the loan at any cost and there may be huge losses in respect of the properties etc. This is for the sole purpose of servicing such non performing accounts.

11. ONE TIME SETTLEMENT SCHEME:

To reduce the absolute amount of nonperforming assets, Government of India along with Reserve Bank of India are announcing one time settlement schemes periodically for the past few years. When the borrowers are alive and when the borrowers are farmers, small entrepreneurs etc and they find it very difficult to pay their dues for various reasons like bad health and fall in their business ventures, , however, they have the inclination to repay their debts to the banks, this type of practice is very much helpful to the borrowers and the lending institutions. Surely the banks are in a position to lose certain portion of their loan amount when they are conducting one time settlement schemes.

12. SUIT FILING:

Filing of suit is taken up as a last resort when all other remedies to recover nonperforming assets fail. Banks can initiate recovery proceedings with or without intervention of the courts of law. To expedite the process, banks should be alert and proactive in all stages of the proceedings. i.e. preparation of plaint, service of summons, written statements, trial of the suit, obtaining decree copy, praying for interim relief, execution of decrees, attachment of the property, arrest of the defendants, if needed etc.

Popular schemes introduced by RBI:

Reserve Bank of India brought Strategic Debt Restructuring (SDR) means banks will assume management control that was not successful, so another scheme called 5/25 introduce by RBI. in this scheme loans that were given for 20 to 25 years tenure period changed to 5 to 25 years through refinancing in which they can sold the bad debts to some other person.

Recently in the month of June 2016 RBI introduced Scheme for Sustainable Structuring for Stressed Assets (S4A) to reduce the stress on corporate borrowers and also to bring bans out of the problem of NPAs. Hindustan Corporation Company Limited is the first company to join under this scheme.

Magnitude of NPAs

In India, the NPAs that are considered to be at higher levels than those in other countries have of late, attracted the attention of public. The Indian banking system had acquired a large quantum of NPAs, which can be termed as legacy NPAs. NPAs seem to be growing in public sector banks over the years. The following table of gross and net NPAs of various sector banks revealing the real picture.

Causes for Non-Performing Assets

A strong banking sector is important for a flourishing economy. The failure of the banking sector may have an adverse impact on other sectors. The Indian banking system, which was operating in a closed economy, now faces the challenges of an open economy. On one hand a protected environment ensured that banks never needed to develop sophisticated treasury operations and Asset Liability Management skills. On the other hand a combination of directed lending and social banking relegated profitability and competitiveness to the background. The net result was unsustainable NPAs and consequently a higher effective cost of banking services.

One of the main causes of NPAs into banking sector is the directed loans system under which commercial banks are required a prescribed percentage of their credit (40%) to priority sectors. As of today nearly 7 percent of Gross NPAs are locked up in 'hard-core' doubtful and loss assets, accumulated over the years. The problem India Faces is not lack of strict prudential norms but

- The legal impediments and time consuming nature of asset disposal proposal.
- Postponement of problem in order to show higher earnings.
- Manipulation of debtors using political influence.

Macro Perspective behind NPAs

A lot of practical problems have been found in Indian banks, especially in public sector banks. For Example, the government of India had given a massive wavier of Rs. 15,000 Crs. under the Prime Minister ship of Mr. V.P. Singh, for rural debt during 1989-90. This was not a unique incident in India and left a negative impression on the payer of the loan. Poverty elevation programs like IRDP, RREP, SUME, SEPUP, JRY, PMRY etc., failed on various grounds in meeting their objectives. The huge amount of loan granted under these schemes were totally unrecoverable by banks due to political manipulation, misuse of funds and non-reliability of target audience of these sections. Loans given by banks are their assets and as the repayment of several of the loans were poor, the quality of these assets were steadily deteriorating. Credit allocation became 'Lon Melas', loan proposal evaluations were slack and as a result repayment were very poor.here are several reasons for an account becoming NPA.

* Internal factors

* External factors

Internal factors:

1. Funds borrowed for a particular purpose but not use for the said purpose.
2. Project not completed in time.
3. Poor recovery of receivables.
4. Excess capacities created on non-economic costs.
5. In-ability of the corporate to raise capital through the issue of equity or other debt instrument from capital markets.
6. Business failures.
7. Diversion of funds for expansion\modernization\setting up new projects\ helping or promoting sister concerns.
8. Wilful defaults, siphoning of funds, fraud, disputes, management disputes, mis-appropriation etc.,
9. Deficiencies on the part of the banks viz. in credit appraisal, monitoring and follow-ups, delay in settlement of payments\ subsidiaries by government bodies etc.

External factors:

1. Sluggish legal system
2. Scarcity of raw material, power and other resources.
3. Industrial recession**.**
4. Shortage of raw material, raw material\input price escalation, power shortage, industrial recession, excess capacity, natural calamities like floods, accidents.
5. Failures, nonpayment\ over dues in other countries, recession in other countries, externalization problems, adverse exchange rates etc.
6. Government policies like excise duty changes, Import duty changes etc.,

In the context of economic liberalisation and growing trend towards globalisation (external liberalisation), various banking sector reforms have been introduced in India to improve the operation efficiency and upgrade the health and financial soundness of banks so that Indian banks can meet internationally accepted standards of performance.

Reforms in the banking sector were introduced on the basis of the recommendations of different committees:

(i) The first Narasimhan Committee (1991),

(ii) The Verma Committee (1996),

(iii) The Khan Committee (1997), and

(iv) The Second Narasimhan Committee (1998).

The First Phase of Reforms:

The banking sector reforms are directed toward improving the policy framework, financial health and the institutional framework:

(a) Change in Policy Framework:

Improvement in policy framework has been undertaken by reducing the Cash Reserve Ratio (CRR) to the initial standard and phasing out Statutory Liquidity Ratio (SLR), deregulation of interest rates, widening the scope of lending to priority sectors and by linking the lending rates to the size of advances.

(b) Improving Financial Health:

Attempts to improve the financial soundness of the banking sector have been made by prescribing prudential norms. Moreover, steps have been taken to re-duct the proportion of Non-Performing Assets (NPAs).

(c) Improvements of Institutional Framework:

Such improvements have been achieved in three ways:

(i) Recapitalisation,

(ii) Creating a competitive environment, and

(iii) Strengthening the supervisory system.

Second Phase Reforms:

The first phase of the bank sector reforms is completed. The second generation reforms which are underway concentrate on strengthening the very foundation of the banking system in three ways: by reforming the structure of the bank industry, technological up gradation, and humankind resource development.

Prudential Regulation:

There are two types of banking regulations—economic and prudential. In the pre-reform era (before July 1991) the Reserve Bank of India (RBI) regulated banks by imposing constraints on interest rates, tightening entry norms and directed lending to ensure judicious end use of bank credit.

However, such economic regulation of banks hampered their productivity and efficiency. Hence, the RBI switched over to prudential regulation which calls for imposing minimum limit on the capital level(s) of banks.

The objective is to maintain the wealth of banks in particular and to ensure the soundness of the financial system in general. It allows much greater scope for the free play of market forces than what is permitted by economic regulations alone.

On the basis of recommendations of the Committee on Banking Sector Reforms, April 1998 (the second Narasimhan Committee) the RBI issued prudential norms. The major objective of setting such norms was to ensure financial safety, soundness and solvency of banks. These norms are directed toward ensuring that banks carry on their operations as prudent entities, are free from undue risk-taking, and do not violate banking regulations in pursuit of profit.

The main focus of reforms was in three areas:

(i) NPAs,

(ii) Capital adequacy, and

(iii) Diversification of operations,

(i) Non-Performing Assets (NPAs):

One serious problem faced by the public sector banks in the 1990s was a high proportion of NPAs. An NPA is an asset from which income is overdue for more than six months. According to the second Narasimhan Committee report (1998), “No other single indicator reflects the quality of assets and their impact on banks’ viability than the NPA figures in relation to advances.”

The gross NPAs of scheduled commercial banks (SCBs) increased over the period March 31, 1998 to March 31, 2002 from Rs 50,815 crores to Rs 70,904 crores. Gross NPA of public sector banks (PSBs) were also correspondingly higher. However, the share of PSBs in total NPAs declined from 90% to 80% during the period (1998-2002).

Furthermore, there was a decline in the ratio of gross NPAs and net NPAs, measured as percentage of advances as well as assets. These ratios represent the quality of banks assets and are thus taken as measures of soundness of the banking system. Gross and net NPAs as a proportion of gross advances and total assets of SCBs declined substantially during this period.

However, the ratio of gross and net NPAs as a proportion of gross advances and of total assets increased substantially for new private sector banks from 2001-02 due to the merger of strong banks with weak banks.

But the root cause of increase in NPAs is the increasing proportion of bad debt. In case of some banks, net NPAs even exceeded their net worth. This means that such banks had negative net worth.

RBI Guidelines:

The RBI offered three options to banks to restructure bad debts:

(i) Debt Recovery Tribunals (DRTs);

(ii) Settlement Advisory Committees (SACs); and

(iii) Recapitalisation from the Government.

Guidelines on SACs were revised in July 2002 to provide a uniform, simplified, non-discriminatory and non-discretionary mechanism for the recovery of the stock of NPAs of all banks.

Altogether, seven DRTs have been set up for speedy recovery of loans. Finally with a view to enhancing the effectiveness of DRTs, the Central government amended the Recovery of Debts due to Banks and Financial Institutions Act in Jan, 2002.

(ii) Capital Adequacy Ratio:

Banking sector reforms were initiated by implementing prudential norms consisting of Capital Adequacy Ratio (CAR). The core of such reforms has been the broadening of prudential norms to the internationally accepted standards.

In 1988 the Basle Committee for international banking supervision made an attempt worldwide to reduce the number of bank failures by tying a bank's CAR to the riskiness of the loans it makes. For instance, there is less chance of a loan to a government going bad than a loan to, say, an internet business. So, the bank will not have to hold as much capital in reserve against the first loan as against the second.

Throughout the world, commercial banks are under the legal obligation to maintain minimum capital funds for the sake of safety. The reason is that a bank's capital base is vitally important for its long-term variability. It also acts as a shock absorber in the medium term since it gives the power to absorb shocks and thus avoid the risk of bankruptcy.

A bank's capital funds must be equivalent to the prescribed ratio on the aggregate of the risk weighted assets and other exposures. CAR is a measure of the amount of a bank's capital expressed as a percentage of its risk weighted credit exposures. It is related to risk weight assigned to asset acquired by banks in the normal process of conducting business. It is also related to the proportion of capital to be maintained on such aggregate risk weighted assets.

CAR is calculated on the basis of risk weightage on assets in the books of accounts of banks. Any type of business transaction carried out by a bank involves a certain specific type of risk. So, for the sake of safety, a portion of capital has to be set aside to make provision for this risk. This portion acts as a hedge against uncertainty, i.e., a 'secret reserve' to absorb any possible future loss.

Higher Capital Adequacy will improve the efficiency of banks in two ways:

(i) By forcing banks to reduce operating costs, and

(ii) By improving long-term viability through risk reduction.

Capital adequacy enables banks to mobilise more capital at reasonable cost.

The two important new parameters which are crucial for the growth of banks are asset quality and risk weightage.

On the basis of the Basle Committee proposals (1988), two tiers of capital have been prescribed for Indian SCBs:

Tier I—capital which can absorb losses without forcing a bank to stop trading, and

Tier II—capital which can absorb losses only in the event of a winding up.

Following the recommendations of the first Narasimhan Committee (1991) the RBI directed the banks to maintain a minimum capital of 8% as the risk-weighted assets; the second Narasimhan Committee (1998) suggested raising the ratio further. In March 2002, the capital to risk-weighted asset ratio (CRAR) was raised to 9%. It was subsequently raised to 10% with a view to tightening of the capital adequacy norm further.

At the end of March 2002, all SCBs (except five) had CRARs in excess of the stipulated 9%. The capital of PSBs has increased through government capital infusion, equity issues to public, and retained earnings.

iii) Diversification in Bank Operations:

During the period of economic liberalisation PSBs have diversified their activities considerably. They have moved in new areas such as mutual funds, merchant banking, venture capital funding and other para-banking activities such as leasing (lease financing), hire-purchase, factoring and so on.

The main objective has been to make profits by deriving maximum economies of scale and scope, enlarging customer base and providing various types of banking services under one umbrella (both directly as also through subsidiaries). Many banks such as the SBI have become a one-stop financial services centre.

Unit III: Introduction to Insurance

3.1. Introduction to insurance

Risk

Risk is an integral part of life. It can be defined as a probability or unexpected threat that may result in damage or loss of property or injury to or death of a person

These may be due to occurrence of a negative event that may be caused due to internal factors or external factors.

For instance when one is driving down the road, one is open to the risk of meeting with an accident. One may take adequate precautions to avoid it, thereby reducing the probability to minimal for the happening of such an event, but under no circumstances can there be a surety that such an event will never happen.

Financial Implications of Risk

In the event of damage due to the happening of an untoward event there would be a financial loss apart from other damages associated with the same.

Such financial loss could occur in any of the following manner:

- In case the event results into the death of a person there could be a loss of source of earnings for his family especially if was the earning member.
- In case of injury to a person, resulting in temporary or permanent disability, the financial loss could be on account of both medical expenditure and loss of earning due to his disability.
- In case of loss or damage is caused to property, movable or immovable, the financial loss will be the amount required to replace or repair the said property, as the case may be.

Illustration

Radheshaym is the sole earning member of the family. His age is 40. He is working as an electrician in a Private Firm earning a salary which is barely adequate to meet his monthly expenses .He has two children – a boy aged 15 and a girl aged 12. His wife is a homemaker. Unfortunately he was diagnosed for cancer which resulted in his death. Since he was the sole earning member the family would be deprived of earnings.

In another case Ghanshyam met with a road accident. Though he was able to survive the accident but unfortunately losses his leg. This tragedy would lead to both medical expenditure on his treatment which may be a prolonged one and also his earning capacity may be substantially reduced because as a result of loss of limb he would be able to do limited jobs

Now let us examine another situation. Mohan Singh runs a small enterprise of manufacturing some products. He has set up a factory by investing all his savings and taking loans from various sources. The manufacturing activity takes place in this factory. Unfortunately fire breaks up in his factory causing substantial damage to the plant and machinery and completely destroying the stocks. He would now require funds to repair or replace the damaged plant and machinery. He would also need funds to purchase raw materials to produce new stocks. All this would lead to financial loss. If he does not arrange for such funds he will not be able to revive his factory and his business will come to a standstill. His losses would further increase due to the loss of business till the time he is able to restart his factory.

What is common in all the above mentioned three cases? All three situations were unpredictable. But we run the risk of such kind of mishap happening anytime. There can be innumerable situations like these.

In all such situations one thing is common. There is a financial loss, apart from other losses, which can cause major distress to those who would be affected by such situations.

Insurance --- Mechanism of Covering Risk:

Insurance is a mechanism by which the person exposed to the potential risk, arising out of the events beyond his control, transfers the financial loss; in part or in full to a third party. The party which transfers his potential loss is termed as the 'Insured' and the party which indemnifies or undertakes to compensate the insured of such potential loss is termed as 'Insurer'

- The Insurer provides the coverage for the potential financial loss in lieu a fee or a consideration which is called the 'Premium'.
- Thus Insurance is a special type of contract between the Insurer (the Insurance Company) and the Insured (the client) wherein:
- The client agrees to pay a premium to the Insurance Company. Such premium may be a fixed amount payable as a single payment or it may be paid as periodical payments. This will depend upon the type of Insurance and the terms thereof.
- In lieu of the payment of such premium the Insurance Company agrees to make some payment to the client or bear the costs of the client due to financial loss incurred on the occurrence of certain events.

For example, in vehicle insurance, the Insurance Company pays the cost of repairing the vehicle if it is damaged in an accident.

Illustration:

We have seen in the illustrations given in the preceding paragraphs that due to unforeseen or unpredictable circumstances the effected parties suffer financial losses. This can really put them in distress.

Insurance is a mechanism by which the effected party is able to get a compensation for the financial loss that is suffered by him as a result of these unforeseen incidents.

In case either of the persons who suffered because of these incidents i.e. Radheshaym, Ghanshyam or Mohan Singh had taken an Insurance Policy from Insurance Company the compensation would have come from the Insurance Company. In such case Radheshaym or Mohan Singh would be the Insured and the Insurance Company that provided the insurance cover would be the Insurer. The insurance company(i.e. the insurer) would enter into a contract with the Insurer to compensate him for the financial loss that is suffered by him. The consideration under this contract of insurance would be the premium which the Insured would give to the Insurer i.e. the Insurance Company.

It is important to note here that the contract of insurance would provide for the circumstances in which the insurance company would be liable to compensate the financial loss. In case the circumstance or the event that resulted in the financial loss is not covered in the contract of Insurance and a loss has been caused the Insurance Company would not be liable to pay compensation.

For instance if in case of a car the insurance contract between the car owner and the Insurance Company provides that the insurance cover would be provided in case of accident and if the car gets damaged due to a fire, the insurance company would not be liable to give any compensation for the loss incurred by the Insured.

For instance if in case of a car the insurance contract between the car owner and the Insurance Company provides that the insurance cover would be provided in case of accident and if the car gets damaged due to a fire, the insurance company would not be liable to give any compensation for the loss incurred by the Insured.

Functions of Insurance

The basic function of Insurance is to reimburse the financial loss resulting from the occurrence of an event. This function is generally carried out by Insurance Company. The Insurance Company provides for various types of Insurances to different people in consideration of a premium. These premiums are collected by the Insurance Companies and are utilized to provide compensation to those who have suffered the loss.

In this context Insurance can also be defined as a collective device used to spread the loss caused by particular risk to one person over a number of people who are exposed to it and who agree to insure themselves against the risk.

Thus to, put it in simple words, the function of insurance is to spread the loss of an individual over a large number of persons who have agreed to cooperate with each other. The larger the number of such persons the easier is the process of distribution of loss. The mechanism of sharing the loss is by way of contributing to the loss is by payment of premium.

3.2. Need and importance of insurance

The functions of Insurance can be stated in two parts viz: (a) Primary Functions (b) Secondary Functions. These are described in detail as follows:

Primary Functions

Insurance provides certainty of payments for loss incurred

Insurance provides certainty of payment for the losses that may be caused due to occurrence of an uncertain event. For instance, a car meeting with an accident is uncertain. However, if the accident takes place it could result into damage. Again, the quantum of loss is uncertain. The only certainty in this case is that in case the car is insured against an accident and the car is damaged due to an accident, the Insured will certainly get compensation for the Loss from the Insurance Company. Insurance, by itself, cannot prevent the occurrence of an event. However, it can compensate for the loss incurred on the occurrence of an event.

Risk Sharing

Insurance provides for sharing of financial loss. It is a method through which losses of some people are divided among large number of people. All those who are insured add up their premiums to compensate loss to those who have incurred the same.

The Insurance Company targets to get as many insured as possible to take up the insurance and accordingly pay premium so that the number of persons who incur loss is much less than those who have taken the Insurance Policy.

Thus all those who have taken the insurance and have paid premium would share the loss of those few who have incurred the loss.

Secondary Functions of Insurance

Besides the primary functions, Insurance also performs the following functions:

Prevention of Loss

Insurers join hands with the Institutions which are engaged in prevention of loss of Society. These Institutions could be Health Organizations, Fire Brigade, educational institutions and other organizations which are engaged in prevention of loss of the masses from death, damage etc.

In case losses are contained the Insurance Company will have enough corpuses (i.e. funds) to pay compensation to those who have incurred losses and will accordingly reduce premium. This will increase profitability of both business organizations and individuals.

Providing Investment Avenues

Insurance plays an important role in providing funds to the businesses, governments etc. The funds that are mobilized through premiums are invested in various financial instruments such as Government securities, corporate shares, bonds and also as loans.

Thus insurance helps in meeting the requirement of funds of all the issuers of these securities and those who borrow the funds.

Improves Efficiency

Insurance provides security to the Insured and is an effective tool of increasing efficiency. Since the insured is not worried about the potential loss as knows that he would be compensated in case such loss is incurred, he would be free of all worries and would devote his time to the job or any other activity that he is involved in with full force. This will, hence, increase his efficiency.

Benefits of Insurance

Insurance serves many purposes and has many benefits for both individuals and businesses. Insurance policies are purchased or taken to provide protection against the potential or unexpected future losses.

The benefits or advantages of Insurance can be outlined as follows:

Peace of Mind: When the consumers take an insurance policy they can achieve peace of mind. They would have a comfort level if they know that in case of happening of an untoward incident; at least the financial loss incurred by them would be compensated.

The objective of taking a policy in respect of a property or an asset is to protect the same. This would be applicable in respect of assets such as homes, vehicles, jewellery and other valuable tangible items.

In case an insurance policy is taken the Insurer will replace or repair these assets if they are damaged, lost or destroyed.

Physical Protection

Certain type of Insurance Policies is designated in such a manner that they protect the body.

In the event that a person is injured, disabled or otherwise physically harmed these insurances will compensate for those damages.

Asset Protection

Income Protection: Certain Insurance policies are designed in such a manner that they protect an individual’s ability to earn a living.

If for some reason the person is no longer able to continue with gainful employment these policies can be structured to replace a majority of lost income of the said person.

Lifestyle Protection

In the event of death of a person, his next of kin suffer the most especially if the person who died was the sole or the major income earner. In such a case a Life Insurance Policy would provide funds to the next of the kin who would be able to maintain partly, if not fully, the lifestyle or at least meet their basic needs.

3.3. Principles of Insurance

Insurance Policy

As stated above Insurance is a contract between the Insured and the Insurer whereby the Insurer, in lieu of the payment of premium by the insured, agreed to compensate the loss incurred by the Insured on the occurrence on an event as provided in the said contract?

This contract of Insurance is contained in a document called ‘Insurance Policy’. As we will see in the following sections there are various types of Insurance Policies. Whatsoever is the type of Insurance Policy it will consist of the following sections:

Declaration of Information

This section, generally, contains the following details:

- Details of the Insured i.e. his name, address etc. The Insured is also known as the Policy Holder.
- Details of the Insurer i.e. the Insurance Company that is issuing the policy
- The risk or the property that is covered
- The policy limits i.e. the amount of insurance or the sum assured.
- The period of the policy

- The amount of Premium

Definitions

This section defines the exact meaning of certain words and phrases used within the policy so that such terms are clearly understood by the Insured and there is no confusion or misinterpretation of the same.

Terms of Policy

This part of the Insurance Policy specifically describes the risks that are covered or the nature of coverage. This section generally summarizes the terms of contract between the parties.

Exclusions

This section provides or describes the circumstances in which the risk will not be covered in the policy. Thus under the circumstances provided in this section the compensation will not be payable by the Insurer.

For example under an automobile insurance policy one of the condition would be that the policy holder will not be entitled to receive compensation for an accident if the person who was driving the vehicle at the time of the accident was intoxicated i.e. was under the influence of alcohol.

Endorsements

Lastly many Insurance Policies end with the Endorsement section. Endorsements are those provisions or conditions which are specific to the policy.

Generally the other sections contain standard conditions. Since this contains certain conditions that are specific to the policy, they will have an overriding effect over the Standard Conditions.

This means that in case the standard conditions and the conditions and those in this section are contradictory to each other the conditions of this section will prevail over standard conditions.

3.4. Characteristics of insurance contract.

History and Meaning of Insurance

Man on earth always had an eye on the avoidance of ill-luck and has tried in all ages somehow to ensure himself and to take out a policy of some sort on which he paid a regular premium in some form of social denial and sacrifice.

Summer and Keller

It existed in some form of mutual or communal protection in the Aryan tribes some 3000 years back.

– Stone and Cox

Transactions in the shape of Bottomry Bonds were done in Italy in 12th and 13th Century A.D.

The word "Bima" was derived from the Persian word "Bim" meaning "Fear" and "Bima" means "expense" incurred to get rid of fear.

Persian Dictionary

From the beginning human societies have tried to find ways to soften the shocks of existence. Our ancestors were very much aware that no individual could do it alone, only by pooling the resources of the many; the unfortunate few could be helped.

This simple idea of mutual cooperation persists like a welcome footpath through the incredible tangle of human history. For example, in ancient times, enterprising merchants sent caravans and ships to trade with all parts of the known world: with Egypt, Phoenicia, India and China.

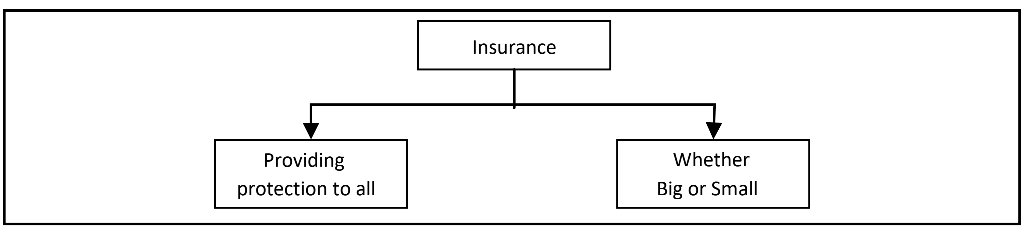
Traders in olden times devised a system of contracts in which the supplier of the capital of business would agree to cancel the loan if the trader was robbed of his goods. The trader who borrowed the capital paid an extra sum (a premium) for this kind of protection over and above the usual interest. As for the lender, collecting these premiums from many traders made it possible for him to absorb the losses of the unfortunate few, who really suffered the loss.

Above arrangement proved to be more sensible and appealing than the earlier one whereby the trader's ship and other tangible property as well as his life and those of his family as well was pledged (as a slave).

Accordingly, the practice was sensibly legalized in the code of Hammurabi in 2100 B.C. The Phoenicians and the Greeks applied a similar kind of system to their sea-born commerce. The Romans used burial clubs as a form of life insurance, providing funeral expenses for members and later on, for payments to the survivors for their future subsistence.

With the growth of towns and trade in Europe, the medieval guilds undertook to protect their guild members from losses by fire and shipwreck, provide ransom to get free from the captivity of pirates, and support in sickness and poverty and to provide decent burial. By the middle of the 14th centuries as evidenced by the earliest known insurance contract (Genoa, 1347), marine insurance was practically universal among the maritime nations of Europe.

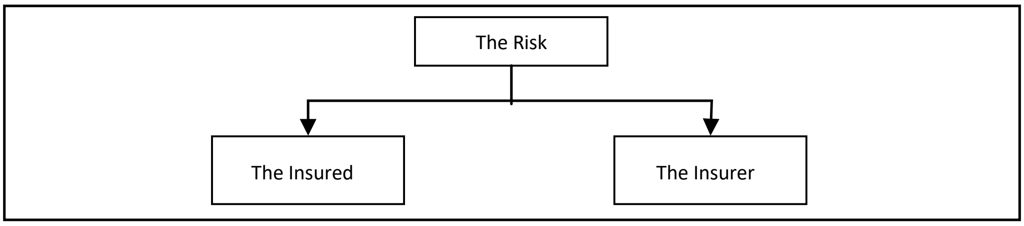
The first kind of formal insurance business was marine insurance. Traders who met in the Lloyd's coffee house in London agreed to share the losses of their goods carried by ships while on voyage to various countries. The losses normally occurred due to attack of pirates who robbed on the high seas or because of bad weather, which spoiled and destroyed the goods or sinking of the ship. The first insurance policy was issued in England in 1583.



Risk, as discussed in last chapter, is the uncertainty of a financial risk. Insurance primarily creates counter part of the risk, which is security.

Insurance is defined as a cooperative device to spread the loss caused by a particular risk over a number of persons who are exposed to it and

- It does not reduce the risk,
- It does not alter the probability of risk, but
- It only reduces/spreads the financial losses. Insurance may be defined in two ways



Thus, insurance is a financial arrangement that spreads the costs of losses among the members of an insurance pool.

Indian Insurance Industry

India insurance is a flourishing industry, with several national and international players competing and growing at rapid rates. Thanks to reforms and the easing of policy regulations, the Indian insurance sector been allowed to flourish, and as Indians become more familiar with different insurance products, this growth can only increase, with the period from 2010 - 2015 projected to be the 'Golden Age' for the Indian insurance industry.

Indian Insurance Policies at a Glance

Indian insurance companies offer a comprehensive range of insurance plans, a range that is growing as the economy matures and the wealth of the middle classes increases. The most common types include: term life policies, endowment policies, joint life policies, whole life policies, loan cover term assurance policies, unit-linked insurance plans, group insurance policies, pension plans, and annuities. General insurance plans are also available to cover motor insurance, home insurance, travel insurance and health insurance.

Due to the growing demand for insurance, more and more insurance companies are now emerging in the Indian insurance sector. With the opening up of the economy, several

Notes international leaders in the insurance sector are trying to venture into the India insurance industry.

Indian Insurance: History

The history of the Indian insurance sector dates back to 1818, when the Oriental Life Insurance Company was formed in Kolkata. A new era began in the India insurance sector, with the passing of the Life Insurance Act of 1912.

The Indian Insurance Companies Act was passed in 1928. This act empowered the government of India to gather necessary information about the life insurance and non-life insurance organizations operating in the Indian financial markets.

The Triton Insurance Company Ltd. formed in 1850 and was the first of its kind in the general insurance sector in India. Established in 1907, Indian Mercantile Insurance Limited was the first company to handle all forms of India insurance.

Indian Insurance: Sector Reform

The formation of the Malhotra Committee in 1993 initiated reforms in the Indian insurance sector. The aim of the Malhotra Committee was to assess the functionality of the Indian insurance sector. This committee was also in charge of recommending the future path of insurance in India.

The Malhotra Committee attempted to improve various aspects of the insurance sector, making them more appropriate and effective for the Indian market.

The recommendations of the committee put stress on offering operational autonomy to the insurance service providers and also suggested forming an independent regulatory body.

The Insurance Regulatory and Development Authority Act of 1999 brought about several crucial policy changes in the insurance sector of India. It led to the formation of the Insurance Regulatory and Development Authority (IRDA) in 2000.

The goals of the IRDA are to safeguard the interests of insurance policyholders, as well as to initiate different policy measures to help sustain growth in the Indian insurance sector.

The Authority has notified 27 Regulations on various issues which include Registration of Insurers, Regulation on insurance agents, Solvency Margin, Reinsurance, Obligation of Insurers to Rural and Social sector, Investment and Accounting Procedure, Protection of policy holders' interest etc. Applications were invited by the Authority with effect from 15th August, 2000 for issue of the Certificate of Registration to both life and non-life insurers. The Authority has its Head Quarter at Hyderabad. Detailed information on IRDA is available at their web-site www.irdaindia.org

Protection of the interest of policy holders

- IRDA has the responsibility of protecting the interest of insurance policyholders. Towards achieving this objective, the Authority has taken the following steps:

- IRDA has notified Protection of Policyholders Interest Regulations 2001 to provide for: policy proposal documents in easily understandable language; claims procedure in both life and non- life; setting up of grievance redressal machinery; speedy settlement of claims; and policyholders' servicing. The Regulation also provides for payment of interest by insurers for the delay in settlement of claim.

- The insurers are required to maintain solvency margins so that they are in a position to meet their obligations towards policyholders with regard to payment of claims.

- It is obligatory on the part of the insurance companies to disclose clearly the benefits, terms and conditions under the policy. The advertisements issued by the insurers should not mislead the insuring public.

- All insurers are required to set up proper grievance redress machinery in their head office and at their other offices.
- The Authority takes up with the insurers any complaint received from the policyholders in connection with services provided by them under the insurance contract.

Basic Terminology related to Contract of Insurance

Insurance Contract: Legally binding unilateral agreement between an insured and an insurance company to indemnify the buyer of a contract under specified circumstances. In exchange for premium payment(s) the company covers stipulated perils.

Capacity of parties: Legal capability of those involved in mutual assent of making a contract, including an insurance contract. Those who have been deemed to be incompetent to make a valid contract include intoxicated and insane persons, and enemy aliens, Minors can enter into a contract, but it is voidable at the option of the minor.

Legal plan: Group arrangement in which a network of attorneys provides legal services to the participants in the plan with the attorney fees being reimbursed by the provider. The attorneys who are members of the network provide their legal services at a reduced rate from their customary fee to the plan participants.

Indemnity: It is compensation for loss. In a property and casualty contract, the objective is to restore an insured to the same financial position after the loss that he or she was in prior to the loss. But the insured should not be able to profit by damage or destruction of property, nor should the insured be in a worse financial position after a loss.

Conditional: Terms specifying obligations of an insured to keep a policy in force. For example, an insured must pay the premiums due; in life insurance, if death occurs, the beneficiary or the insured's estate must submit proof of death; if there is a property loss, the insured must submit proof of loss.

Insurable interest: Relationship between an insured person or property and the potential beneficiary of the policy. For example, a wife has an insurable interest in her husband's life, because she would be financially harmed if he were to die. Therefore, she could receive the proceeds of the insurance policy if he were to die while the policy was in force. If there is no insurable interest, an insurance company will not issue a policy.

Mutual assent: Offer and acceptance upon which an agreement is based. For a contract to be legal (and thus enforceable in a court of law), an offer must be made by one party to another party, who accepts the offer. If properly negotiated, the insurance contract is deemed to be a contract of mutual assent.

Consideration: Something of value that one party gives to another in exchange for a promise or act. A consideration can be in the form of money, commodities, or personal services; in many industries the forms have become standardized.

Legal Definitions

According to Chief Justice Tindal, "Insurance is a contract in which sum of money is paid by the assured in consideration of the insurers incurring the risk of paying a large sum upon a given contingency."

According to Britannica Encyclopaedia, "Insurance may be described as a social device whereby a large group of individuals through a system of equitable contributions may reduce or eliminate certain measurable risks of economic loss common to all members of the group."

In legal terms, insurance is a contractual agreement whereby one party agrees, for a consideration called premium, to compensate another party for losses. Thus, an insurance transaction involves the following:

Insurer: The party agreeing to pay for the losses of the insured.

Insured: The party who insured his risk with the insurer.

Premium: The payment to the insurer received from the insured for indemnifying the losses.

Policy: It is the contract between the insurer and insured that sets the contractual obligation between the two.

Exposure to loss: The insured's possibility of incurrence of loss is called the insured's exposure to loss.

How Insurance Works

The mechanism of insurance is very simple. People who are exposed to the same kind of risks come together and agree that, if any one of them suffers a loss, the others will share the loss and make good to the person who lost. All people who send goods by ship are exposed to the same risks, which are related to water damage, ship sinking, and piracy etc. Those owning factories are not exposed to these risks, but they are exposed to different kinds of risks like fire, hailstorms, earthquakes, lightning, burglary etc.

Like this, different kinds of risks can be identified and separate groups made. By insurance, the heavy loss that anyone or few of them may suffer is divided into bearable small losses by all. In other words, the risk is spread among the community and the likely big impact on one or few is reduced to smaller manageable impacts on all.

There are certain principles also, which make it possible for insurance to remain a fair arrangement. The first being sharing of risk as it is difficult for any one individual to bear the consequences of the risks that he is exposed to. It will become bearable when the community shares the burden.

The second is that the peril should occur in an accidental manner. Nobody should be in a position to make the risk event occur. In other words, none in the group should set fire to his assets and ask all others to share the costs of damage as this would be taking unfair advantage of an arrangement which is there to protect people from the risks they are exposed to. The occurrence of loss has to be random, accidental, and not the deliberate action of the insured person(s).

The manner in which the loss is to be shared can be determined beforehand. It may be proportional to the risk that each person is exposed to. This would be indicative of the benefit he would receive if the peril befell him. Insurance companies collect the share of people to the pool in advance and create a fund from which the losses can be paid.

The collection to be made from each person in advance is determined on some assumptions. While it may not be possible to tell beforehand, which person will suffer, it may be possible to tell on the basis of past experiences, how many persons, on an average, may suffer losses. The following illustrations make the concept of insurance clear.

Example 1: In a particular colony there are 600 houses each having a worth of Rs.. 30000.

Every year there is a probability of 3 houses getting burnt. The resultant loss per house is Rs 30000 and total loss being Rs 90000. If all the 600 home owners pool Rs 150 each to the pool the unfortunate people whose houses were burnt can be easily paid.

Example 2: There are 10000 persons in a city who all are aged 40 and are healthy. It is expected that of these, 10 persons may die during the year. If the economic value of the loss suffered by the family of each dying person is taken to be Rs. 30000, the total loss would work out to Rs. 3,00,000/-. If each person in the group contributed Rs. 100/- a year, the common fund would be Rs.10,00,000/-. This would be enough to pay Rs. 30,000/- to the family of each of the ten persons who die. Thus, 10000 persons share the risk of 10 persons.

The surplus, if any, after payment of claims remains in the fund which is utilized to meet future excess losses or returned back to policyholders in one or the other form.

Human being - Are they Assets?

A human being is an income-generating asset. One's manual labour, professional skills are the assets. Human assets can also be lost like other assets due to causes like - early death, fatal sickness and death caused by accidents.

Accidents may or may not happen. Death will happen, sooner or later but the timing is uncertain. Insurance is necessary to help those dependent on the income of a person.

Insurance - Is it a Business?

Insurance companies are called insurers. The business of insurance is to:

- Bring together the persons with common insurance interests (sharing the same risks)
- Collect the share or contribution (called premium) from all of them and
- Pay out compensations (called claims) to those who suffer.

An Insurance policy, like all other contracts, creates rights and corresponding duties for the parties to the contract. Let us examine the rights and responsibilities of the insurer and the insured.

- Rights and Responsibilities of the Insurer and Insured

- Rights and Responsibilities of the Insurer
- Rights and Responsibilities of the Insurer are listed below:

1. **Right to collect premium from the insured**: Insurer has a right to collect in advance a specified sum as premium for his taking obligation of reimbursing the loss to the insured as and when it occurs. An insurer pays the claims to the insured from the pool of funds so build up through collection of premiums. In fact, an insurer loads the premium with his administrative costs (management expenses and agents commission) as well.
2. **Right to specify the rules and conditions that govern the promise made under the policy**: Insurer explicitly states as to what risks the policy covers and the terms and conditions subject to which such losses will be reimbursed.
3. **Responsibility to pay for the losses occurred and claimed by the insured**: Once the insured suffers losses and lodges claim, the insurer is obliged to honour payments provided they are within the contractual terms.

Rights and Responsibilities of Insured

Obligation to pay premium to the insurer: The insured has to pay the prescribed premium to the insurer so as to create a contractual obligation on the part of insurer to reimburse the losses as and when they occur.

Right to collect payment from the insurer if a covered loss occurs: In the event of materialization of risk, the insured is entitled to claim reimbursement of losses from the insurer.

Obligation to comply with the terms and conditions prescribed by insurer: The insured has to comply with all the terms and conditions laid down in the policy and also agreed by him at time of creating the policy.

In an insurance contract, one should remember that a right created for one party represents a duty for the other party. In the event of default of premium or non-compliance of conditions by insured, an insurer may cancel the insurance or refuse to pay claims/payment of losses.

Nature of Insurance Contract

Insurance is a contract. A contract of insurance is a contingent contract. The general principles of law of contract must be complied with for a contract of insurance to be valid. Contract of insurance comes into existence where there is an offer (from the person facing the risk) and the underwriter or the insurer accepts it by issuing the policy. The contract of insurance (in order to be a valid contract) can be entered into only by person(s) competent to contract.

A contract of insurance other than life insurance contract is a contract of indemnity. The insurer undertakes to indemnify the insured for loss or damage arising as a result of risk specified. In case of life insurance, if a person dies the insurance company can only give a specified claim amount as compensation to the survivors; it cannot indemnify the loss of lost life as the person who is dead cannot be brought back.

Differences between Insurance Contract and Wagering Contract

People have sometimes said that the contract of insurance whether it is marine, fire or life insurance it is similar to a wagering contract.

Example: Once Mr. 'A' promised to pay Mr.' M' a sum of Rs, 50,000 if India won the cricket match against Australia that day. Payment of this sum depends on the future event, which at the time of contract is of uncertain nature. If the event does not happen no payment will be made. This is a wagering contract.

However, contract of insurance is different. The following are the points of distinction between the Insurance Contract and Wagering Contract:

Insurance Contract	Wagering Contract
1. Insurable interest is the subject matter in contract of insurance	1. In a Wagering Contract, the interest in the asset or event is limited. Parties are interested in knowing only for the purpose of winning or losing upon the future events.
2. Contract of insurance is essentially based on principles of indemnity.	2. In a Wagering Contract, there is no question of indemnity because no risk is covered.
3. Contract of insurance is legally enforceable.	3. A Wagering Contract is void because it is not recognized by law.
4. Contract of insurance is based upon the principles of good faith i.e., full disclosure of material facts required by both parties to contract.	4. There is no question of disclosure of material facts as it is not required by either party in Wagering Contract.
5. Risks and Premium are fixed on the basis of scientific methods.	5. No such calculations are made in the Wagering Contract.

Difference between Insurance and Assurance:

Insurance (Non-Life Insurance)	Assurance (Life Insurance)
1. The term ‘Insurance’ is used for non-life insurance contracts.	1. The term ‘Assurance’ is referred to life insurance business.
2. In the case of insurance, loss due to risk is not certain to happen i.e., loss is likely to happen or not.	2. Loss due to risk is certain to happen. Death is bound to happen sooner or later.
3. Generally, goods or property are the subject matter of non-life insurance.	3. Human life is the subject matter of life insurance contract.

4. Insurance contract is usually for one year.	4. Life insurance contract, is a continuing contract, i.e., long-term contract.
5. Fire, marine insurance and other contracts are contracts of indemnity.	5. It is not a contract of indemnity. Since life lost cannot be returned.
6. In fire insurance, insurable interest must be present both at the time of affecting the policy and also at the time of occurrence of loss too. In marine insurance it must be present only at the time of loss. It is not necessary at the time of affecting the policy.	6. Insurable interest must be present only at the time of taking out the policy, but need not be present at the time of maturity of the policy.
7. In the case of marine and fire insurance, policy cannot be surrendered by the assured before its maturity.	7. A life insurance policy can be surrendered by the assured before its maturity.
8. In the case of fire and marine insurance, insurance contain only the protection element.	8. Life insurance contains both the elements of security and investment.

3.5. Branches of insurance

Financial Surveillance and Examination Branch

The Surveillance and Examination (FSE) Branch reviews all filings from companies applying for Certificates of Authority to transact the business of insurance, audits domestic annual financial statements and premium tax statements. In addition, the staff conducts a continuing program of insurance company, agency, mutual and fraternal benefit societies, health maintenance organization financial and/or market conduct examinations, to assure compliance with insurance laws and financial solvency in an effort to safeguard consumer interests and maintain professionalism in the industry.

Compliance and Enforcement Branch

When a complaint is filed with the Insurance Division, the Compliance and Enforcement Branch conducts an investigation to assure compliance with the applicable statutes and rules. Appropriate disciplinary actions are taken by the Compliance and Enforcement Branch when necessary. If it is determined that a case warrants prosecution, it is referred to the Office of the Attorney General for prosecution by the State. To file a complaint, a complaint form must be filled out and submitted to the Hawaii Insurance Division.

Licensing Branch

The Licensing Branch reviews, issues, extends and amends Crop Adjuster, Independent Adjuster, Independent Bill Reviewer, Life Settlement Broker and Provider, Limited Lines Motor Vehicle Rental Company Producer, Limited Lines Portable Electronics, Limited Lines Producers, Managing General Agent, Producer, Public Adjuster, Reinsurance Intermediary Broker and Manager, Surplus Lines Broker and Workers Compensation Insurance Adjuster licenses for both resident and non-resident licensees; issues and extends all Service Contract Provider and Vehicle Protection Product Warrantor registrations; processes renewal notifications, remittance checks, confirmation and cancellation of insurance licenses; administers and maintains data record for the Continuing Education (CE) program; responds to inquiries regarding licensing received over the telephone, email, mail, and in person.

Rate and Policy Analysis Branch

The Rate and Policy Analysis Branch (RPA) devises and implements systems and procedures for the analysis of rate and policy filings by domestic, foreign and alien insurance companies in order to ensure compliance with state insurance laws. The RPA Branch reviews and approves rates used by companies in the sale of its policies to ensure that mandated coverages are provided and that the interests of the buyers are protected.

Insurance Fraud Investigation Branch

The Fraud Branch was formed to conduct a state wide program for the prevention, investigation, and prosecution of insurance fraud cases and violations of all applicable state laws relating to insurance fraud. To find out more about insurance fraud click here.

Heath Insurance Branch

The Health Insurance Branch is responsible for regulating health insurers, including health maintenance organizations and mutual benefit societies. The Branch's primary responsibilities are: handle inquiries and complaints; approve premium rates and policy forms; monitor the solvency of health insurers; and receive requests from consumers for external review of a health plan's coverage decisions and administer the external review process.

Captive Insurance Branch

The Captive Insurance Branch (CI) provides for dedicated resources to facilitate the monitoring, regulation and prudent development of the captive insurance industry in the State of Hawaii.

The CI branch reviews and evaluates each prospective captive application on a case-by-case basis to ensure appropriate economic and social responsibility of each program structure and its related constituencies, as well as, compliance with applicable State laws and regulations. On an ongoing basis, the CI branch utilizes interim and annual reports and filings, and on-site examinations to monitor compliance with the approved applications and business plans.

3.6. Types of insurance

Risk is everywhere: When you drive your car to work, when you visit a new country, when you ride your bike to a nearby shop, when there's a new bug going around in town.

Bottom-line: Customer need the security of insurance.

There are two broad types of insurance:

1. Life Insurance
2. General Insurance

Scenario 1	Scenario 2	Scenario 3	Scenario 4
Your childhood friend suddenly meets with an accident. He passes away, leaving behind a wife, two kids and one elderly parent.	You catch a cold. But work keeps you busy. Eventually, the cold worsens into Pneumonia. You need to be admitted in the ICU for a week.	You are going to Spain for the first time. You have a stop-over at Abu Dhabi. Your first flight gets delayed. You miss the second flight and get stuck.	You are driving to work like every other day. But the road has oil spill. A car spins out of control and hits yours. Your bumper and headlights get hurt.
Your friend had minimal savings, barely enough to cover two months'	It costs you Rs. 60,000 for the hospital charges. And Rs. 10,000 for the	It costs Rs. 28,000 to fly to Spain. Rs. 20,000 to return to India. Plus, the loss from hotel booking	Your bumper costs Rs. 10,000 to repair. The headlights another Rs. 7,000.

Scenario 1	Scenario 2	Scenario 3	Scenario 4
expenses.	treatment.	cancellations.	
A Rs. 7,500 life insurance could have ensured they had Rs 10 lakh in hand.	A Rs. 3,500 health insurance could have ensured you paid 0 from your pocket.	A travel insurance worth Rs. 500 could have helped pay the hospital bills.	Rs. 7,500—that's how much a car insurance costs every year which could have paid for the damages.

Types of Insurance							
Life Insurance				General Insurance			
Term Life	Money-back policy	Unit-Linked Insurance Plan	Pension Plans	Motor Insurance	Home Insurance	Health Insurance	Fire Insurance

Life Insurance

Life insurance is a contract that offers financial compensation in case of death or disability. Some life insurance policies even offer financial compensation after retirement or a certain period of time. Life insurance, thus, helps you secure your family's financial security even in your absence. You either make a lump-sum payment while purchasing a life insurance policy or make periodic payments to the insurer. These are known as premiums. In exchange, your insurer promises to pay an assured sum to your family in the event of death, disability or at a set time.

Life insurance can help you support your family even after retirement. Depending on what it covers, Life insurance can be classified into various types:

Term Insurance	- It is the most basic type of insurance. - It covers you for a specific period. - Your family gets a lump-sum amount in the case of your death. - If, however, you survive the term, no money will be paid to you or your family.
Whole Life Insurance	- It covers you for a lifetime. - Your family receives a certain sum of money after your death. - They will also be entitled to a bonus that often accrues on such amount.
Endowment Policy	- Like a term policy, it is also valid for a certain period. - A lump-sum amount will be paid to your family in the event of your death.

	- Unlike a term plan, you get the maturity proceeds after the term period.
Money-back Policy	- A certain percentage of the sum assured will be paid to you periodically throughout the term as survival benefit. - After the expiry of the term, you get the balance amount as maturity proceeds. - Your family gets the entire sum assured in case of death during the policy period. This is regardless of the survival benefit payments made.
Unit-linked Insurance Plans (ULIPs)	- Such products double up as investment tools. - A part of your premium goes towards your insurance cover. - The remaining amount is invested in Debt and Equity. - A lump-sum amount will be paid to your family in the event of your death.
Child Plan	- This ensures your child's financial security. - In the event of your death, your child gets a lump-sum amount. - The insurer pays the premium amounts after your death. - Your child will continue to get a certain sum of money at specific intervals.
Pension Plans	- This helps build your retirement fund. - You can get a regular pension amount after retirement. - In the case of your death, your family can claim the sum assured.

Tax Benefits

- Life insurance not only ensures the well-being of your family, it also brings tax benefits.
- The amount you pay as premium can be deducted from your total taxable income.
- However, this is subject to a maximum of Rs 1.5 lakh, under Section 80C of the Income Tax Act.
- The premium amount used for tax deduction should not exceed 10% of the sum assured.

General Insurance

A general insurance is a contract that offers financial compensation on any loss other than death. It insures everything apart from life. A general insurance compensates you for financial loss due to liabilities related to your house, car, bike, health, travel, etc. The insurance company promises to pay you a sum assured to cover damages to your vehicle, medical treatments to cure health problems, losses due to theft or fire, or even financial problems during travel.

Simply put, a general insurance offers financial protection for all your assets against loss, damage, theft, and other liabilities. It is different from life insurance.

Situation 1	Situation 2	Situation 3
You plan to propose to your girlfriend on the Eiffel Tower. You already finalized the deal with a jeweler in Paris. But, things don't go as planned and you meet with an accident there.	You cannot stop celebrating your new car. You hit the roads with your latest possession. Everything goes well until a car suddenly tries to overtake you. It leaves huge dents and dislocates your left mirror.	Your daughter wants to become a pilot. You save all your disposable income to fund her dreams. Unfortunately, you fall severely ill.
Your treatment requires Rs. 50,000. But, still paid for that dainty piece of jewellery.	Your new baby on the block needs repairs worth Rs. 30,000. Yet, you have a smile on your face.	You need Rs. 2 lakh for your treatment immediately. Yet, you also easily pay your daughter's course fees.
HOW		
Your Travel insurance made you ready for emergencies. It paid for the expenses related to your accident. You could, thus, go ahead and surprise your partner with a diamond ring without worrying about the treatment costs.	The dent in your car didn't cause a dent in your pocket. Your motor insurance' own damage cover paid for your car's damages caused by the accident. In fact, the insurer settled the bill directly at the garage.	You didn't face a dilemma of choosing one over the other and compromise your daughter's future. Your health insurance took care of your treatment costs. Your savings, thus, remained unaffected by your sudden illness.

Different types of General Insurance available:

1. Health Insurance
2. Motor Insurance
3. Travel Insurance
4. Home Insurance
5. Fire Insurance

1.Health Insurance

This type of general insurance covers the cost of medical care. It pays for or reimburses the amount you pay towards the treatment of any injury or illness.

It usually covers:

- Hospitalization
- The treatment of critical illnesses
- Medical bills prior to or post hospitalization
- Day care procedures like Cataract operations

Customer can also opt for add-on benefits like:

Maternity cover: Your health insurance covers you for the costs related to childbirth. This includes pre-delivery check-ups, hospitalization during delivery, and post-natal care.

Pre-existing diseases cover: Your health insurance takes care of the treatment of diseases you may have before buying the health insurance policy.

Accident cover: Your health insurance can pay for the medical treatment of injuries caused due to accidents and mishaps.

Health insurance can also help you save tax. Premium payment can reduce your taxable income.

For	Tax deduction on the premium amount	Total
Self	Rs. 25,000 (Rs. 30,000 if you are a senior citizen)	Rs. 25,000 (or Rs. 30,000)
Parents, who are senior citizens	Rs. 30,000	Rs. 55,000 (or Rs. 60,000)

Motor Insurance

Motor insurance is for car or bike.

It is a general insurance cover that offers financial protection to your vehicles from loss due to accidents, damage, theft, fire or natural calamities. Motor insurance can also available for commercial vehicles.

In India, you cannot drive or ride without motor insurance.

Let’s look at the two key types:

1. Car Insurance

It’s precious—your car. You paid lakhs of rupees to buy that beauty. Even a single scratch can be painful, forget about bigger damages.

Car insurance can reduce this pain for a few thousand rupees.

How it works:

What the insurer will pay for depends on the type of car insurance plan you purchase

2. Two-wheeler Insurance

This is your bike's guardian angel. It's similar to Car insurance.

You cannot ride a bike or scooter in India without insurance.

How it works:

As with car insurance, what the insurer will pay depends on the type of insurance and what it covers.

Types of Motor Insurance:

Third Party Insurance	Comprehensive Car Insurance
Compensates for the damages caused to another individual, their vehicle or a third-party property.	Covers all kinds of damages and liabilities caused to you or a third party. It includes damages caused by accidents, sabotage, theft, fire, natural calamities, etc.

Travel insurance

Travel insurance compensates or pays for any financial liabilities arising out of medical and non-medical emergencies during your travel abroad or within the country.

There are two types of Travel Insurance.

Single Trip Policy	Annual Multi Trip
It covers you during a trip that lasts under 180 days.	It covers you for several trips you take within a year.

Travel insurance usually covers:

- Loss of baggage
- Emergency medical expenses
- Loss of passport
- Hijacking
- Delayed flights
- Accidental death

Home Insurance

Home insurance is a cover that pays or compensates you for damage to your home due to natural calamities, man-made disasters or other threats.

It covers liabilities due to fire, burglary, theft, flood, earthquakes, and sabotage. It not only offers financial protection to your home, but also takes care of the valuables inside the property.

Some of the common types of home insurance are:

Standard fire and special perils policy	This covers your home against fire outbreaks and special perils. The dangers covered are: - Natural calamities like lightening, flood, storm, earthquake, etc. - Damage caused due to overflowing or bursting of water tanks, pipes, etc. - Damage caused due to man-made activities such as riots, strikes, etc.
Home structure insurance	This protects the structure of your home from any kinds of risks and damages. The cover is also extended to the permanent fixtures within the house such as kitchen and bathroom fittings.
Public liability coverage	The damage caused to another person or their property inside the insured home can also be compensated.
Content Insurance	This covers the content inside the insured home. What’s commonly covered: Television, refrigerator, portable equipment, etc.

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.

Steps involved in Insurance Process:

Step 1:

KNOW WHAT YOU NEED

- Understand the covers you need based on personal requirements.
- Get all the important details. For example, in the case of motor insurance get details such as the manufacturing date of the vehicle, engine specifications, etc. For health insurance, check whether you need insurance for self or the entire family.
- This initial assessment will help you get an idea about the coverage that you need.

Step 2:

CHECK OPTIONS AVAILABLE

- Compare the benefits offered.
- Check the add-ons offered
- Don’t forget to read the exclusions
- What’s the sum assured?

- Are there any extra services offered

Step 3:

PICK THE RIGHT PLAN

- Select the plan that best suits your requirements.
- Reach out to the company offering the plan.

Step 4:

PAY PREMIUM

- Fill in the application and pay the premium.
- You can do it online on the insurer's website.
- You can also buy from a broker or the dealership.

Insurance does not cover the following elements:

Let's have a look at a few of them.

Life	If death occurs due to: - Alcohol or drug abuse - War or terrorism - Suicide or self-inflicted injuries - Gross negligence or carelessness
Car	- Damage caused when the policy is not active - Loss of personal belongings kept in the car - Damage to a car that is not insured - Damage caused when driving without a license - Damage caused when driving under the influence of alcohol or drugs - Damage due to wars, mutiny or nuclear risks
Bike	- Damage due to war, mutiny or nuclear risk - Normal wear and tear and general ageing - Tire or tube punctures. (If, however, your two-wheeler is damaged at the same time, you will be compensated for 50% of the cost of repair or replacement - Mechanical or Electrical breakdown - Any loss or damage caused outside India
Health	- Hospitalization due to war or related activities - Medical condition due to abuse of intoxicants or hallucinogenic substances - Any medical condition existing before buying the policy during the waiting period - Non-allopathic therapies such as acupuncture, yoga, naturotherapy, etc.

	- Diagnostic charges if the reports do not confirm the existence of the covered disease - Self-inflicted injuries
Travel	- Travelling against the advice of the physician - Baggage delay for less than 24 hours - Psychological illness or self-inflicted injuries during your trip - War or civil unrest in international locations - Participation in hazardous sports like bungee jumping, parachuting, etc.
Home	- Willful destruction of the property - Damages caused due to wear and tear - Damages caused due to war - Loss of money kept inside the property - Loss to a property that has remain unoccupied for a certain period
Fire	Loss or damage caused to the property due to: - Nuclear perils - War or related activities - Pollution or contamination - Mechanical or electrical breakdowns

Insurance Cost:

Insurance costs depend on premium amount. This premium amount depends on several factors that differ from insurance to insurance. Here’s a look:

Life Insurance

- Age
- Health (past and current)
- Customer Occupation
- The type of coverage/plan
- Customer smoking and drinking habits
- The sum assured

Motor/Auto Insurance:

- Make-Model of the vehicle
- The type of coverage/plan
- The value, age of your vehicle
- Your claim history

Travel Insurance

- The sum assured

- The type of coverage/plan
- Age
- Your health
- The location of travel

Health Insurance

- Customer family health history
- The sum assured
- The type of coverage/plan
- Customer age and gender
- Customer health history

Home Insurance

- The size of Customer home
- The type of coverage/plan
- The age of Customer home and the systems installed therein
- The location of Customer home
- The sum assured

Usage of the insurance money:

- Customer has to make a claim against insurance policy.
- Give details about the loss you suffered. This differs from insurance to insurance.
- Submit the bills/proof of damage, loss, hospitalisation, etc.
- The insurance company would verify your claim.
- It will then pay the bill or reimburse you for your loss.

Life Insurance

A Life Insurance Policy is a Contract between a person called Insured and an Insurance Company that is engaged in the business of providing Life Insurance cover in lieu of payments of premium.

Life Insurance policies are of two basic types:

Whole Life Policies

In whole life policies the assured amount is paid by the Insurance Company on the death of the insured person to his successors. The premium is required to be paid throughout the life of insured person.

Endowment Policies

Such policies are for specified period only e.g. 10, 15, 20 years. The insured amount becomes payable to the insured on the expiry of such period. If in the meanwhile the insured person dies the amount is payable to his successors.

Thus the objective of life insurance is to provide financial security to the insured or to his family in case he dies.

General Insurance

Insurance Contracts that do not come under the ambit of Life Insurance are called General Insurance or Non Life Insurance Contracts.

Tangible Assets are prone to damage/loss which may be caused by fire, accident, theft etc. General Insurance is taken by the Insured to protect the assets from such potential damages. Thus the different types of General Insurance are fire, marine, vehicle, accident and other non life insurance.

As in the case of Life Insurance, General Insurance Products also come at a price in the form of a premium.

Examples:

In the first case Radheshaym died as a due to cancer. Thus there is a loss of life. This is a case of Life Insurance. In case he had taken a Life Insurance Policy, his family would get the amount assured in the Life Insurance Policy after his death. This would to some extent cover the financial loss that would have been suffered by the family due to death of Radheshaym as he was the sole earning member.

In the second case Ghanshyam has suffered major injuries in the road accident. He has, in fact, become partially incapacitated. This is a case of Non Life Insurance or General Insurance. In case he had taken a Medical Insurance he would be compensated by the Insurance Company for his medical expenditure.

The third case is also a case of Non Life Insurance or General Insurance. In this case there is damage to the property or the assets of Mohan Singh. However there is no loss of life. Hence in this an appropriate cover of Insurance under the category of General Insurance would compensate the loss suffered by Mohan

In line with the above the comparative analysis of Life Insurance and General Insurance would be as follows:

S No	Parameter	Life Insurance	General Insurance
a.	Risk	The element of risk is the death of a person	The element of risk is the damage/ loss to a property or an asset.
b.	Tenure	Long Period	Comparatively shorter period not extending beyond the useful life of the asset.

c.	Beneficiary	In the event of death of the Insured the Beneficiary would be the Legal Heirs of the Insured. In case of Endowment Policy he himself will be the beneficiary if he survives till the maturity of the policy.	The beneficiary would generally be the Insured who would also be, in most cases, the owner of the asset
d.	Payment of Premium	Periodical Payments which could be quarterly, half yearly or yearly	Generally Lump Sum Payment at the time of taking up the Policy.

3.8. Role of agents and brokers.

An agent is a person who represents a principal, who can be another person or a company, and act in the principal's behalf. An insurance agent represents the insurance company and an insurance broker represents the insurance applicant—both must be licensed by the state in which they conduct business.

The main duty of agents and brokers is to sell insurance. They also explain the benefits of insurance, and give their insured information as to what is covered and what isn't. They may also provide service after a loss, informing the insured what steps need to be taken to have the claim paid.

The insurance company is responsible for the acts of its agents, and it can be assumed by the insurance applicant that any information or payment of money to the agent will be received by the insurance company—not necessarily so for the broker, because the broker represents the insurance client, not the company.

Each state has its own licensing requirements for agents and brokers, but the Graham-Leach-Bliley Act (GLB) required more uniform laws so that agents and brokers can work in different states. General requirements include being at least 18 years old, no felony convictions, and passing an insurance examination required by state law. Some states also require continuing education courses to maintain the license. In addition, any life insurance agents who sell variable annuities or variable life insurance must also be licensed by the Securities and Exchange Commission, because these products involve investments of securities.

Fundamentals of Agency Law

There are several general principles to understand in agency law. Most important is knowing the authority that the insurance agent or broker has in representing the insurance company. The law recognizes 3 types of authority: apparent authority, express authority, and implied authority.

There is no presumption of an agency relationship. There must be explicit evidence that the agent represents the insurer.. If someone says that they are an agent of an insurance company, but there is no other evidence to support it, and it later turns out that he was not an agent of the insurance company, then the company will not be liable or bound by the actions of the person claiming to be an agent.

If, however, the agent has a place of business using the insurance company's name, and other materials from the company, then the insurance applicant can accept that the agent actually does represent the company, since the agent has apparent authority to represent the company. Indications of apparent authority include activities that agent and principal have done customarily, but have not included explicitly or implicitly in the agency agreement. If a client perceives the agent to have apparent authority to act in the company's behalf and relies on it, then the insurance company may be bound by the agent's action, even if the agent's action was not granted by the insurer. However, for the company to be so bound, the client must have exercised due diligence. Are the written materials provided by the insurance company? Is the action a reasonable one for the agent to do? Is there anything in the application or other written materials that would indicate otherwise? For instance, if the agent collects the premium, but the insurance application states that the premium should only be sent to the company, then the company may later deny a claim if it was not sent the premium, and the client will not be able to hold the company liable based on the agent's action, because it contradicted the application.

However, if an agent does act outside the scope of his authority, the insurance company may, nonetheless, ratify the agreement or actions.

If an agent represents a company, then the agent must have the authority to do certain things in furthering the principal's interest. An agency agreement binds the principal and agent, and is the source of some of the agent's express authority. Express powers are listed explicitly in the agency agreement, and will generally include not only what the agent can do, but what he cannot do, in representing the principal.

Implied authority (aka incidental authority) is based on implied powers, powers implied by the agent's express powers that allow the agent to fulfill the requirements of the agency agreement. Thus, if a life insurance agent has the authority to deliver the policy, then she would also have the authority to collect the 1st premium, since this is the general procedure if the applicant did not previously pay the premium.

Waiver and Estoppels

The rights of the insurance company may be modified by waiver and estoppels. A waiver is the voluntary relinquishment of a legal right. For instance, if the company issues a policy to an insured whose application had incomplete information, then the company relinquishes the right to deny coverage for a loss that the company would have denied if the information had been complete.

Estoppels are the prevention of the exercise of one's rights because of inconsistent acts or statements that caused someone else to rely on those acts or statements to their detriment. Estoppels differs from a waiver in that the exercise of the right is prevented involuntarily by law because of a previous act or statement by the person or company seeking to exercise it.

So if an insurance agent tells a client that he can mail the premium later than the due date, the insurance company cannot deny payment of a claim for a loss that occurs between the due date and the receipt of the premium, since the agent, who represents the insurance company, said that it could be mailed late.

Insurance Agents

Insurance agents represent 1 or more companies, and so they are restricted to selling policies to particular people and for particular risks that the companies are willing to cover. If an insurance applicant has a particular need, a broker would probably be more appropriate.

Since insurance agents represent the company, anything communicated or given to the agent is legally considered to have been given to the company. If the agent fails to relay material information or the premium to the company, the company cannot later deny payment of a claim because of the failure of the agent to do his duty.

General agents, common in property insurance, have the authority to bind the insurance company, and, thus, can issue a policy immediately as a binder. A binder is evidence of insurance until the policy is actually issued.

Soliciting agents (aka special agents), common in life insurance, solicit business for the insurance company, but do not have the legal authority to bind the company to a contract; the insurance company must approve of the application before the insurance becomes effective.

Insurance Brokers

Insurance brokers represent the applicant, and help the applicant to find the right insurance company at the best price. Businesses use brokers because they often have special insurance requirements, such as employee benefits. A broker can help them develop an insurance plan and write the policy, then find an insurance company willing to take the risk. Because brokers work in the field every day, they are familiar with many insurance companies, and what kind of risks they are willing to insure. Thus, the broker can match the applicant to the insurer—field underwriting.

Brokers are also needed to provide a market for surplus lines. Surplus lines are any type of insurance that is not offered by any insurer that is licensed to do business within the state, and the business must be placed with a non admitted insurer, which is an insurer that is not licensed for that state. This need arises because there is a need for some types of insurance or for a certain amount of coverage that is not provided by any insurance company licensed to do business in the state. When coverage is not available by insurers licensed in that particular state, state law allows the placement of that business with a non admitted insurer, through the services provided by a surplus lines broker, who is a broker licensed to place business with non admitted insurers.

Differences between Insurance Brokers and Agents

The relationship among the broker, the insured and the insurer is different from the relationship among an agent, the insured, and the insurer. Because the broker represents the applicant and not the insurance company, what is communicated or given to the broker is not considered relayed to the insurance company by law, so it is important to deal with a reputable broker. If the insurance applicant conveys material information to a broker, but the broker does not communicate it to the insurance company, the company may, later, deny the payment of a claim because of the concealment of the material information.

In some court cases, however, it has been held that the broker is, in fact, an agent of the company because of the relationship that actually existed between the broker and the company, where the broker served as intermediary between the insured and the insurer in all their dealings. Because many people don't understand the distinction between brokers and agents, and rely on the broker as being the actual representative of the company, some states have passed laws stipulating that insurance brokers are legal agents of the insurance companies, so that consumers can be assured that anything relayed to the broker will have been deemed relayed to the insurance company.

One of the disadvantages of dealing with a broker is that the broker cannot bind the insurance company; thus, the insurance applicant must wait for approval from the insurance company before the insurance is in force. To overcome this limitation, many brokers also are agents of some of the insurance companies.

UNIT IV: INSURANCE BUSINESS ENVIRONMENT

4.1 Regulatory and legal framework governing the insurance sector:

Insurance Regulatory & Development Authority

A. Organizational Structure of IRDAI:

Composition of IRDAI:

As per Sec. 4 of IRDAI Act, 1999, the composition of the Authority is:

a) Chairman;

b) Five whole-time members;

c) Four part-time members,

(appointed by the Government of India)

IRDAI's Head Office is at Hyderabad

All the major activities of IRDAI including ensuring financial stability of insurers and monitoring market conduct of various regulated entities is carried out from the Head Office.

IRDAI's Regional Offices are at New Delhi & Mumbai

The Regional Office, New Delhi focuses on spreading consumer awareness and handling of Insurance grievances besides providing required support for inspection of Insurance companies and other regulated entities located in the Northern Region. This office is functionally responsible for licensing of Surveyors and Loss Assessors. Regional Office at Mumbai handles similar activities, as in Regional Office Delhi, pertaining to Western Region.

B. Insurance Regulatory Framework:

1. Insurance Regulatory and Development Authority of India (IRDAI), is a statutory body formed under an Act of Parliament, i.e., Insurance Regulatory and Development Authority Act, 1999 (IRDAI Act 1999) for overall supervision and development of the Insurance sector in India.

2. The powers and functions of the Authority are laid down in the IRDAI Act, 1999 and Insurance Act, 1938. The key objectives of the IRDAI include promotion of competition so as to enhance customer satisfaction through increased consumer choice and fair premiums, while ensuring the financial security of the Insurance market.

3. The Insurance Act, 1938 is the principal Act governing the Insurance sector in India. It provides the powers to IRDAI to frame regulations which lay down the regulatory framework for supervision of the entities operating in the sector. Further, there are certain other Acts which govern specific lines of Insurance business and functions such as Marine Insurance Act, 1963 and Public Liability Insurance Act, 1991.

4. IRDAI adopted a Mission for itself which is as follows:

- To protect the interest of and secure fair treatment to policyholders;
- To bring about speedy and orderly growth of the Insurance industry (including annuity and superannuation payments), for the benefit of the common man, and to provide long term funds for accelerating growth of the economy;
- To set, promote, monitor and enforce high standards of integrity, financial soundness, fair dealing and competence of those it regulates;
- To ensure speedy settlement of genuine claims, to prevent Insurance frauds and other malpractices and put in place effective grievance redressal machinery;
- To promote fairness, transparency and orderly conduct in financial markets dealing with Insurance and build a reliable management information system to enforce high standards of financial soundness amongst market players;
- To take action where such standards are inadequate or ineffectively enforced;
- To bring about optimum amount of self-regulation in day-to-day working of the industry consistent with the requirements of prudential regulation.

5. Entities regulated by IRDAI:

a. Life Insurance Companies - Both public and private sector Companies

b. General Insurance Companies - Both public and private sector Companies. Among them, there are some standalone Health Insurance Companies which offer health Insurance policies.

c. Re-Insurance Companies

d. Agency Channel

e. Intermediaries which include the following:

- Corporate Agents
- Brokers
- Third Party Administrators
- Surveyors and Loss Assessors.

6. Regulation making process:

- Section 26 (1) of IRDAI Act, 1999 and 114A of Insurance Act, 1938 vests power in the Authority to frame regulations, by notification.
- Section 25 of IRDAI Act, 1999 lays down for establishment of Insurance Advisory Committee consisting of not more than twenty five members excluding the ex-officio

members. The Chairperson and the members of the Authority shall be the ex-officio members of the Insurance Advisory Committee.

- The objects of the Insurance Advisory Committee shall be to advise the Authority on matters relating to making of regulations under Section 26.
- Accordingly the draft regulations are first placed in the meeting of Insurance Advisory Committee and after obtaining the comments/recommendations of IAC, the draft regulations are placed before the Authority for its approval.
- Every Regulation approved by the Authority is notified in the Gazette of India.
- Every Regulation so made is submitted to the Ministry for placing the same before the Parliament.

7. The Authority has issued regulations and circulars on various aspects of operations of the Insurance companies and other entities covering:

- Protection of policyholders' interest
- Procedures for registration of insurers or licensing of intermediaries, agents, surveyors and Third Party Administrators;
- Fit and proper assessment of the promoters and the management
- Clearance /filing of products before being introduced in the market
- Preparation of accounts and submission of accounts returns to the Authority.
- Actuarial valuation of the liabilities of life Insurance business and forms for filing of the actuarial report;
- Provisioning for liabilities in case of non-life Insurance companies
- Manner of investment of funds and periodic reports on investments
- Maintenance of solvency
- Market conduct issues

C. Supervisory Role:

1. The objective of supervision as stated in the preamble to the IRDAI Act is "to protect the interests of holders of Insurance policies, to regulate, promote and ensure orderly growth of the Insurance industry", both Insurance and Reinsurance business. The powers and functions of the Authority are laid down in the IRDAI Act, 1999 and Insurance Act, 1938 to enable the Authority to achieve its objectives.
2. Section 25 of IRDAI Act 1999 provides for establishment of Insurance Advisory Committee which has Representatives from commerce, industry, transport, agriculture, consume for a, surveyors agents, intermediaries, organizations engaged in safety and loss prevention,

research bodies and employees' association in the Insurance sector are represented. All the rules, regulations, guidelines that are applicable to the industry are hosted on the website of the supervisor and are available in the public domain.

3. Section 14 of the IRDAI Act,1999 specifies the Duties, Powers and functions of the Authority. These include the following:

- To grant licenses to (re) Insurance companies and Insurance intermediaries
- To protect interests of policyholders,
- To regulate investment of funds by Insurance companies, professional organisations connected with the (re)Insurance business; maintenance of margin of solvency;
- To call for information from, undertaking inspection of, conducting enquiries and investigations of the entities connected with the Insurance business;
- To specify requisite qualifications, code of conduct and practical training for intermediary or Insurance intermediaries, agents and surveyors and loss assessors
- To prescribe form and manner in which books of account shall be maintained and statement of accounts shall be rendered by insurers and other Insurance intermediaries;

D. Prudential approach: Reporting, Risk monitoring and intervention:

1. Reporting Requirements:

Insurers are required to submit various returns like financial statements on an annual basis duly accompanied by the Auditors' opinion statement on the annual accounts; reports of valuation of assets, valuation of liabilities and solvency margin; actuarial report and abstract and annual valuation returns giving information about the financial condition for life Insurance business; Incurred But Not Reported claims in case of general Insurance business; Reinsurance plans on an annual basis; and monthly statement on underwriting of large risks in case of general Insurance companies; details of capital market exposure on a monthly basis; Investment policy, Quarterly and annual returns on investments.

2. Solvency of Insurers:

In order to monitor and control solvency requirements, it has been made mandatory to the insurers to submit solvency report on quarterly basis. In case of any deviation, the Supervisor initiates necessary and suitable steps so as to ensure that the Insurer takes immediate corrective action to restore the solvency position at the minimum statutory level.

Computation of solvency margin takes into account the inherent risk that respective line of business poses to the insurer. Higher requirements are placed for risky lines of business compared to others posing less risk to the insurers. Even though the insurers are required to maintain a minimum solvency ratio of 150% at all times, the actual solvency margin maintained by insurers are well above the required solvency margin leading to the solvency margin ratio significantly higher than 150% on average.

Quarterly solvency ratio reports have to be submitted to the Supervisor, maintaining minimum solvency ratio of 150%. This provides the regular a mechanism to monitor the solvency position periodically over the financial year in order to ensure compliance with the requirements and hence to initiate suitable action in the event of any early warning signal on the Insurer's financial condition.

3. Asset-Liability Management:

Under Asset-Liability Management reporting, Insurer must provide the year wise projected cash flows, in respect of both assets and liabilities. Insurers must maintain mismatching reserves in case of any mismatch between assets and liabilities as a part of the global reserves. Further, Life insurers are required to submit a report on sensitivity and scenario testing exercise in the prescribed format. Non-life insurers must submit a report on 'Financial Condition' covering the sensitivity analysis of the financial soundness in meeting the policyholders' liabilities.

The supervisor requires management of investments to be within the insurer's own organization. In order to ensure a minimum level of security of investments in line with Insurance Act Provisions, the regulations prescribe certain percentages of the funds to be invested in government securities and in approved securities. The regulatory framework lays down the norms for the mix and diversification of investments in terms of Types of Investment, Limits on exposure to Group Company, Insurer's Promoter Group Company. Investment Regulations lay down the framework for the management of investments. The exposure limits are also prescribed in the Regulations. The Investment Regulations require a proper methodology to be adopted by the insurer for matching of assets and liabilities.

4. Reinsurance:

Transfer of risk through Reinsurance is recognized only to the extent specified in the regulations. Due safeguards are built in to ensure that adjustments are made to provide for quality of assets held. No other risk transfer mechanism exists in the current system. In order to minimize the counterparty risk, the re-insurers with whom business is placed must have the minimum prescribed rating by an independent credit rating agency as specified in the regulations. Legislation has specified the minimum capital requirements for an Insurance company. It further, prescribes that Insurance companies can capitalize their operations only through ordinary shares which have a single face value.

Reinsurer

General Insurance Corporation of India (GIC of India) is the sole National Reinsurer, providing Reinsurance to the Insurance companies in India. The Corporation's Reinsurance programme has been designed to meet the objectives of optimising the retention within the country, ensuring adequate coverage for exposure and developing adequate capacities within the domestic market. It is also administering the Indian Motor Third Party Declined Risk Insurance Pool – a multilateral Reinsurance arrangement in respect of specified commercial vehicles where the policy issuing member insurers cede Insurance premium to the Declined Risk pool based on the underwriting policy approved by IRDAI.

5. Corporate Governance:

In order to protect long- terms interests of policyholders, the IRDAI has outlined appropriate governance practices applicable to Insurance companies for maintenance of solvency, sound long-term investment policy and assumption of underwriting risks on a prudential basis from time to time. The IRDAI has issued comprehensive guidelines for adoption by Insurance companies on the governance responsibilities of the Board in the management of the Insurance functions. These guidelines are in addition to provisions of the Companies Act, 1956, Insurance Act, 1938 and other applicable laws.

Corporate Governance Guidelines issued by IRDAI, requires insurers to have in place requisite control functions. The oversight of the control functions is vested with the Boards of the respective insurer. It lays down the structure, responsibilities and functions of Board of Directors and the senior management of the companies. Insurers are required to adopt sound prudent principles and practices for the governance of the company and should have the ability to quickly address issues of non-compliance or weak oversight and controls.

The Guidelines mandated the insurers to constitute various committees viz., Audit Committee, Investment Committee, Risk Management Committee, Policyholder Protection Committee and Asset-Liability Management Committee. These committees play a critical role in strengthening the control environment in the company.

6. on and off site Supervision:

Onsite Inspections:

The Authority has the power to call for any information from entities related to insurance business – Insurance companies and the intermediaries, as may be required from time to time.

On site inspection is normally carried out on an annual basis which includes inspection of corporate offices and branch offices of the companies. These inspections are conducted with view to check compliance with the provisions of Insurance Act, Rules and regulations framed thereunder.

The inspection may be comprehensive to cover all areas, or may be targeted on one, or a combination of, key areas. When a market-wide event having an impact on the insurers occurs, the Supervisor obtains relevant information from the insurers, monitors developments and issues directions as it may consider necessary. Though there is no specific requirement, events of importance trigger such action. The supervisor reviews the "internal controls and checks" at the offices of Insurance companies, as part of on-site inspection.

Off-site Inspection:

The primary objective of off-site surveillance is to monitor the financial health of Insurance companies, identifying companies which show financial deterioration and would be a source for supervisory concerns. This acts as a trigger for timely remedial action.

The off-site inspection conducted by analyzing periodic statements, returns, reports, policies and compliance certificates mandated under the directions issued by the Authority from time to time. The periodicity of these filings is generally annual, half-yearly, quarterly and monthly and are related to business performance, investment of funds, remuneration details, expenses of management, business statistics, auditor certificates related to various compliance requirements.

The statutory and the internal auditors are required to audit all the areas of functioning of the Insurance companies. The particular area of focus is the preparation of accounts of the company to reflect the true and fair position of the company as at the Balance Sheet date. The auditors also examine compliance or otherwise with all statutory and regulatory requirements, and in particular whether the Insurance company has been compliant with the various directions issued by the supervisor. In addition, the Authority relies upon the certifications which form part of the Management Report. The Board is required to certify that the management has put in place an internal audit system commensurate with the size and nature of its business and that it is operating effectively.

All Insurance companies are required to publish financial results and other information in the prescribed formats in newspapers and on their websites at periodic intervals.

7. Micro Insurance and Rural & Social Sector Obligations

The IRDAI had issued micro Insurance regulations for the protection of low income people with affordable Insurance products to help cope with and recover from common risks with standardized popular Insurance products adhering to certain levels of cover, premium and benefit standards. These regulations have allowed Non Governmental Organizations (NGOs), Self Help Groups (SHGs) and other permitted entities to act as agents to Insurance companies in marketing the micro Insurance products and have also allowed both life and non-life insurers to promote combi-micro Insurance products.

The Regulations framed by the Authority on the obligations of the insurers towards rural and social sector stipulate targets to be fulfilled by insurers on an annual basis. In terms of these regulations, insurers are required to cover year wise prescribed targets (i) in terms of number of lives under social obligations; and (ii) in terms of percentage of policies to be underwritten and percentage of total gross premium income written direct by the life and non-life insurers respectively under rural obligations.

4.2 Brief history of Insurance in India

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 1st 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.

Liberalization, Privatization and Globalization have opened new horizons in Insurance Industry. This has resulted in many international players setting up joint ventures in India with Indian Partners. Till recently the limit on Foreign Investment in Entities doing Insurance business was 26% which has recently (year 2015) been increased to 49%.

Thus this millennium has seen insurance come a full circle in a journey extending to nearly 200 years.

Regulatory Authority for Insurance Sector

The authority that regulates Insurance Sector in India at present is 'Insurance Regulatory and Development Authority of India (IRDA). It is an autonomous apex statutory body which regulates and develops Insurance Industry in India. It was constituted by a special Act of Parliament called Insurance Regulatory and Development Authority Act 1999.

The Mission Statement or the Objectives of IRDA are:

- To protect the interest of and secure fair treatment to policyholders
- To bring about speedy and orderly growth of the insurance industry (including annuity and superannuation payments), for the benefit of the common man, and to provide long term funds for accelerating growth of the economy;
- To set, promote, monitor and enforce high standards of integrity, financial soundness, fair dealing and competence of those it regulates;
- To ensure speedy settlement of genuine claims, to prevent insurance frauds and other malpractices and put in place effective grievance redressed machinery.
- To promote fairness, transparency and orderly conduct in financial markets dealing with insurance and build a reliable management information system to enforce high standards of financial soundness amongst market players;
- To take action where such standards are inadequate or ineffectively enforced
- To bring about optimum amount of self-regulation in day-to-day working of the industry consistent with the requirements of prudential regulation

IRDA is a ten member body consisting of:

- A Chairman
- Five whole time members
- Four part time members

The specific functions of IRDA are as follows:

- To give permission to set up Insurance Companies in Private Sector.
- Regulating investment of funds by Insurance Companies.
- Regulating various agencies, persons etc concerning Insurance Companies.
- Private Investment in Insurance Sector
- The transfer of ownership, property or business from the Government to private sector is termed as Privatization.

Life Insurance Business was nationalized in the year 1956 and General Insurance Business was nationalized in the year 1972.

After nationalization Life Insurance Corporation had monopoly over Life Insurance Business. Similarly after nationalization, General Insurance Corporation was set up as a Holding Company. It had four subsidiaries: New India, Oriental, United India and National Insurance Companies.

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.

The setting up of Insurance Regulatory & Development Authority (IRDA) in the year 1999 paved the way for liberalization and privatization of Insurance Sector to private sector.

IRDA has separated out Life, Non Life and Reinsurance business. Therefore a company has to have separate licenses for each line of business.

Recently in the year 2015 the limit of Foreign Investment in Insurance Business has been increased from 26% to 49% something that was under discussion for more than a decade.

Also global re insurance companies have been allowed to set up branches in India, something that was not allowed earlier.

Structure of Insurance Business in India

The insurance industry of India consists of 52 insurance companies of which 24 are in life insurance business and 28 are non-life insurers.

Among the life insurers, Life Insurance Corporation (LIC) is the sole public sector company. Apart from that, among the non-life insurers there are four public sector insurers. In addition to these, there is sole national re-insurer, namely, General Insurance Corporation of India.

Insurance Companies in Public Sector

The Insurance Companies in Public Sector are as follows:

- Life Insurance Corporation of India
- General Insurance Corporation of India
- National Insurance Company Limited.
- Oriental Insurance Company Limited
- New India Assurance Company Limited
- United India Insurance Company Limited

The details and structure of each of these Companies is as follows:

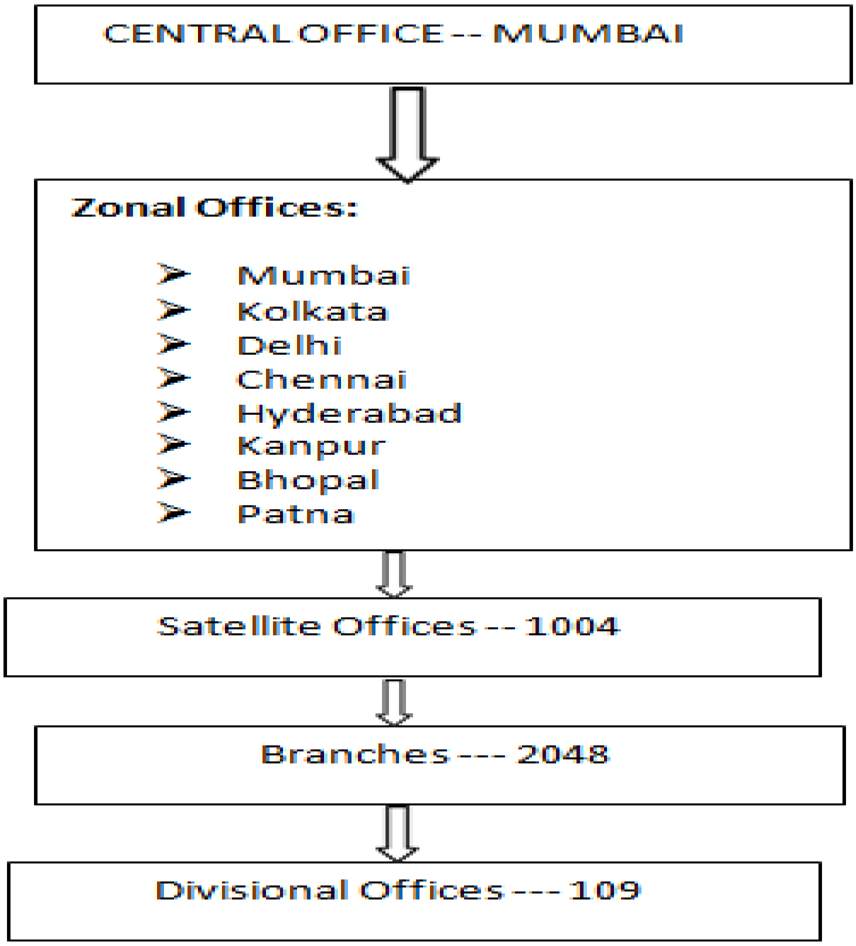
Life Insurance Corporation of India

Life Insurance Corporation of India, the sole Public Sector Company carrying out Life Insurance Business in India, was established by a special Act of Parliament called Life Insurance Corporation Act. This Act was enacted by the Parliament on the 19th of June 1956.

The main objective of setting up Life Insurance Corporation was to spread the message of Life Insurance in the country and to mobilize and channelize the savings of Public at large which could be used for nation building. It was aimed at spreading awareness of Life Insurance in rural areas so that maximum lives may be insured at a reasonable cost.

Organizational Structure of LIC (as on 31/3/2010)

Life Insurance Company has its Central Office in Mumbai and 8 Zonal Offices in different parts of the country. Under Zonal Offices are Divisional offices followed by Branches and satellite offices. LIC also has three branches in territories outside India. The organizational structure of LIC in India is depicted in the following chart.



Apart from the above LIC have three International Branches as follows:

- Mauritius
- United Kingdom
- Fiji

Life Insurance Corporation also operates in Overseas Insurance Market through Joint Ventures as follows:

- Life Insurance Corporation International B SC (C) registered in Baharin
- Ken India Assurance Company registered in Nairobi.
- Life Insurance Corporation (Nepal) Limited registered in Kathmandu.
- Life Insurance Corporation (Lanka) Limited registered in Colombo.
- Saudi India Company for Cooperation in Insurance registered in Riyadh.
- Life Insurance Corporation (Mauritius) Offshore Ltd. registered in Port Louis, Mauritius is a Joint Venture Company between LIC of India and GIC of India.
- A representative office has also been recently established in Singapore.

General Insurance Corporation

General Insurance Corporation of India (GIC) was approved as ‘Indian Reinsurer’ on 3rd November 2000. It provides reinsurance cover to Insurance Companies engaged in General Insurance (Non Life Insurance)

‘Reinsurance is a process whereby one entity (the reinsurer) takes on all or part of the risk covered under a policy issued by an insurance company in consideration of a payment of premium. In other words it is a form of an insurance cover for insurance companies.

As an Indian reinsurer GIC has been giving support to four public sector and other private sector general insurance companies.

GIC also has a presence in foreign reinsurance business through branch offices in Dubai and London and a representative office in Moscow.

Apart from reinsurance business, GIC continues to participate in the share capital of

- Ken India Assurance Company Ltd (Kenya)
- India International Insurance Pvt. Ltd, Singapore
- LIC (Mauritius) Offshore Ltd, a joint venture company promoted by LIC of India in Mauritius.

General Insurance Companies in Public Sector

As of now there are four General Insurance Companies in Public Sector in India. These are as follows:

- National Insurance Company Ltd.
- New India Assurance Company Limited
- Oriental Insurance Company Ltd
- United India Insurance Company Ltd.

These Companies function independently. However they have formed an association known as General Insurance (Public Sector) Association of India (GISPA) with headquarters in Delhi.

The four Public Sector General Insurance Companies have a total of 101 Regional Offices, 1395 Divisional Offices, 2880 branch offices in India and 43 Overseas Offices.

These four Public Sector Insurance Companies have contributed along with General Insurance Corporation of India(GIC) and NABARD (National Bank of Agriculture and Rural Development) to set up a Crop Insurance Company called Agricultural Insurance Company of India Ltd.

This Company provides crop insurance to protect the farmers against crop losses suffered due to natural calamities. The Head Office of this Company is in New Delhi.

Insurance Companies in Private Sector

Liberalization, Privatization and Globalization have opened new horizons in Insurance Industry. This has resulted in many international players setting up joint ventures in India with Indian Partners. Till recently the limit on Foreign Investment in Entities doing Insurance business was 26% which has recently (year 2015) been increased to 49%.

Accordingly, if any foreign company has to do business in India in the Insurance Sector it has to collaborate with an Indian partner and its maximum holding in the Indian Entity would be up to 49%.

As of now there are 23 insurance companies in the Private Sector carrying out Life Insurance business. These are as follows:

S No	Name of Insurance Company
1.	Bajaj Alliance Life Insurance Company Limited
2.	Birla Sun Life Insurance Company Limited
3.	HDFC Standard Life Insurance Company Limited
4.	ICICI Prudential Life Insurance Company Limited
5.	ING Vysya Life Insurance Company Limited
6.	Max New Life Insurance Company Limited
7.	Metlife Insurance Company Limited
8.	Kotak Mahindra Old Mutual Life Insurance Company Limited
9.	SBI Life Insurance Company Limited
10.	TATA AIG Life Insurance Company Limited
11.	Reliance Life Insurance Company Limited
12.	Aviva Life Insurance Company Limited
13.	Shriram Life Insurance Company Limited
14.	Sahara India Life Insurance Company Limited
15.	Bharti AXA Life Insurance Company Limited
16.	Future Generalli India Life Insurance Company Limited
17.	IDBI Fortis Life Insurance Company Ltd
18.	Canara HSBC Oriental Bank of Commerce Life Insurance Company Limited
19.	AEGON Religare Life Insurance Company Limited

20.	DLF Pramerica Life Insurance Company Limited
21.	Star Union Dai- ICHAI Life Insurance Company Limited
22.	India First Life Insurance Company Limited
23.	Edelwise Tokio Life Insurance Company Limited

Similarly there are 22 insurance companies in general Insurance under the Private Sector. These are as follows:

S No	**Name of Company**
1.	Bajaj Alliance General Insurance Company Limited
2.	ICICI Lombard General Insurance Company Limited
3.	IIFCO- TOKIO General Insurance Company Limited
4.	Reliance General Insurance Company Limited
5.	Royal Sundaram Alliance Insurance Company Limited.
6.	TATA AIG General Insurance Company Limited
7.	Colamandalum General Insurance Company Limited
8.	HDFC ERGO Insurance Company Limited
9.	Star Health Allied Insurance Company Limited.
10.	Apolo D KV Insurance Company Limited.
11.	Shri Ram General Insurance Company Limited
12.	Max Buppa Health Insurance Company Limited
13.	Future Generalli India Insurance Company Limited
14.	Universal Sompo General Insurance Company Limited.
15.	Bharti AXA General Insurance Company Ltd
16.	Raheja QBE General Insurance Company Limited
17.	L&T General Insurance Company Limited
18.	Religare Health Insurance Company Limited
19.	Magma HDI General Insurance Company Limited

20.	Liberty Vidoecon General Insurance Company Limited
21.	SBI General Insurance Company
22.	Cigna TTK Health Insurance Company Limited

Role of Insurance in Financial System

Insurance is a part of financial system. Financial system may be defined as set of institutions, instruments and markets, which gather savings and channel them to their most efficient use.

The system consists of individuals (savers), intermediaries, markets and users of savings. Economic activity and growth are greatly facilitated by the existence of the market in mobilizing the saving and allocating them among competing users.

An economy needs institutions that impartially enforce property rights and contracts. Economic growth of a country depends on the existence of a well functioning financial infrastructure. It is essential that the financial infrastructure be developed sufficiently so that the market operates in an efficient manner.

Insurance as a part of the financial system provides valuable services to those affected by various risks or contingencies.

It takes care of the financial consequences of certain specific contingencies but in insurance terminology, such contingencies are called risks and they cause losses when they occur.

The effect of these losses on financial system is not only negative but may be disastrous and catastrophic also. It results in substantial burden on the financial well-being of those affected.

The insurance sector supports the financial system in several ways. A few have been enumerated below:

It accepts the risk from people and corporate bodies who are exposed to them.

It collects small amounts of premium, which are pooled together to be called an insurance fund. This fund is used for investment purpose.

It organizes compulsory insurance in certain areas as per the provisions of the law.

It sells voluntary insurance covers through its sales force.

It settles claims arising out of insured losses. Neither the insurance company nor the insured are allowed to make profits out of insurance. If insurance company gets a surplus after meeting claims, it distributes it among policyholders in form of bonus or reduction in premium. It follows the principles of Indian Contract Act, which help to prevent its misuse or abuse.

Functions and Characteristics of Insurance

Functions of Insurance

- It helps capital formation
- It provides certainty
- It provides protection
- It helps prevention of losses
- It shares risk.

Characteristics of Insurance

An insurance contract has the following characteristics, which are generally, observed in case of all kinds of insurance contracts whether life, marine, fire, or miscellaneous insurance.

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 the death of 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,

Example: 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.

Cooperative 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 cooperative 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).

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. The likelihood of an event is assigned a numerical value between 0 and 1. Those events that are impossible are assigned a value of 0 and those that are inevitable are assigned a value of 1. The higher values (between 0 and 1) are assigned to those events estimated to have a greater likelihood or probability of occurrence.

Payment of claim at the occurrence of contingency: The payment is made on happening of a certain contingency insured. It is true for all non-life insurances that payment will be made on 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. For 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 expiry of the period.

Amount of payment: The amount of payment depends upon the value of loss suffered due to the happening of 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.

It is immaterial in life insurance what was the amount of loss at the time of contingency. But in the property and general insurances, the amount of loss, as well as the happening of loss, are required to be proved.

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. The ultimate objective is to keep the insurance cost as low as possible.

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 owners 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 to take insurance amounts to gambling because the uncertainty of loss is always looming on the head.

One could also say, 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.

Salient features of IRDA Act

The IRDA Authority has the duty to promote, regulate and ensure orderly growth of the insurance and reinsurance businesses across India, subject to the provisions of this Act and any other additional law that is being enforced.

Without prejudice to the generality of the provisions contained in sub-section (1) of IRDA Act, the powers and functions of the Authority shall include:

Issuing a certificate of registration to the applicant as well as modify, renew, withdraw, suspend or cancel any such registration that is deemed unfit.

Protecting the interests of the policyholders in matters concerning assigning of insurance policy, nomination by policyholders, settlement of insurance claim, insurable interest, surrender value of policy and other terms and conditions based on contracts of insurance.

Specifying requisite qualifications, practical training and code of conduct for insurance intermediaries, insurance brokers and agents.

- Specifying the code of conduct for surveyors and loss assessors.
- Promotion of efficiency in the conduct of insurance business.
- Promoting and regulating professional organizations connected with the insurance and reinsurance business across India.
- Levying fees, commission and other charges for carrying out the purposes of this Act.

Calling for data or information from, undertaking inspection of, conducting enquiries and investigations, conducting audit of the insurers, intermediaries, insurance intermediaries and other organizations connected with the insurance business.

Under section 64U of the Insurance Act, 1938 (4 of 1938), controlling and regulation of the rates, advantages, terms and conditions etc. that may be offered by insurers (or Insurance Companies) in respect of general insurance business not so controlled and regulated by the Tariff Advisory Committee.

Specifying the manner and form in which books of account shall be maintained and statement of accounts, financial statements etc shall be rendered by insurers and other insurance intermediaries.

- Keeping a tab, exercising control and regulating investment of funds by insurance companies.
- Regulating the maintenance of margin of solvency by the Insurers.
- Adjudication of disputes between insurers and intermediaries or insurance intermediaries, hospitals, healthcare organizations or with customers.
- To effectively supervise the functioning of the Tariff Advisory Committee.
- Specifying the percentage of premium income of the insurer to finance schemes for promoting and regulating professional organizations referred to in clause (f);
- Specifying the percentage of life insurance business and general (or non-life) insurance business to be undertaken by the insurance company in the rural or social sector.
- Exercising any such other powers that may be prescribed with passage of time.

History of IRDAI

In India insurance was mentioned in the writings of Manu (Manusmrithi), Yagnavalkya (Dharmasastra) and Kautilya (Arthashastra), which examined the pooling of resources for redistribution after fire, floods, epidemics and famine the life-insurance business began in 1818 with the establishment of the Oriental Life Insurance Company in Calcutta; the company failed in 1834. In 1829, Madras Equitable began conducting life-insurance business in the Madras Presidency. The British Insurance Act was enacted in 1870, and Bombay Mutual (1871), Oriental (1874) and Empire of India (1897) were founded in the Bombay Presidency. The era was dominated by British companies.

In 1914, the government of India began publishing insurance-company returns. The Indian Life Assurance Companies Act, 1912 was the first statute regulating life insurance. In 1928 the Indian Insurance Companies Act was enacted to enable the government to collect statistical information about life- and non-life-insurance business conducted in India by Indian and foreign insurers, including provident insurance societies. In 1938 the legislation was consolidated and amended by the Insurance Act, 1938, with comprehensive provisions to control the activities of insurers.

The Insurance Amendment Act of 1950 abolished principal agencies, but the level of competition was high and there were allegations of unfair trade practices. The Government of India decided to nationalise the insurance industry.

An ordinance was issued on 19 January 1956, nationalising the life-insurance sector, and the Life Insurance Corporation was established that year. The LIC absorbed 154 Indian and 16 non-Indian insurers and 75 provident societies. The LIC had a monopoly until the late 1990s, when the insurance industry was reopened to the private sector.

General insurance in India began during the Industrial Revolution in the West and the growth of sea-faring commerce during the 17th century. It arrived as a legacy of British occupation, with its roots in the 1850 establishment of the Triton Insurance Company in Calcutta. In 1907 the Indian Mercantile Insurance was established, the first company to underwrite all classes of general insurance. In 1957 the General Insurance Council (a wing of the Insurance Association of India) was formed, framing a code of conduct for fairness and sound business practice.

Eleven years later, the Insurance Act was amended to regulate investments and set minimum solvency margins and the Tariff Advisory Committee was established. In 1972, with the passage of the General Insurance Business (Nationalisation) Act, the insurance industry was nationalized on 1 January 1973. One hundred seven insurers were amalgamated and grouped into four companies: National Insurance Company, New India Assurance Company, Oriental Insurance Company and United India Insurance Company. The General Insurance Corporation of India was incorporated in 1971, effective on 1 January 1973.

The re-opening of the insurance sector began during the early 1990s. In 1993, the government set up a committee chaired by former Reserve Bank of India governor R.N.Malhotra to propose recommendations for insurance reform complementing those initiated in the financial sector. The committee submitted its report in 1994, recommending that the private sector be permitted to enter the insurance industry. Foreign companies should enter by floating Indian companies, preferably as joint ventures with Indian partners.

Following the recommendations of the Malhotra Committee, in 1999 the Insurance Regulatory and Development Authority (IRDA) were constituted to regulate and develop the insurance industry and was incorporated in April 2000. Objectives of the IRDA include promoting competition to enhance customer satisfaction with 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 an invitation for registration applications; foreign companies were allowed ownership up to 26 percent. The authority, with the power to frame regulations under Section 114A of the Insurance Act, 1938, has framed regulations ranging from company registrations to the protection of policyholder interests since 2000.

In December 2000, the subsidiaries of the General Insurance Corporation of India were restructured as independent companies and the GIC was converted into a national re-insurer. Parliament passed a bill de-linking the four subsidiaries from the GIC in July 2002. There are 28 general insurance companies, including the Export Credit Guarantee Corporation of India and the Agriculture Insurance Corporation of India, and 24 life-insurance companies operating in the country. With banking services, insurance services add about seven percent to India’s GDP.

In 2013 the IRDAI attempted to raise the foreign direct investment (FDI) limit in the insurance sector to 49 percent from its current 26 percent. The FDI limit in the sector was raised to 49 percent in June 2016.

IRDAI functions:

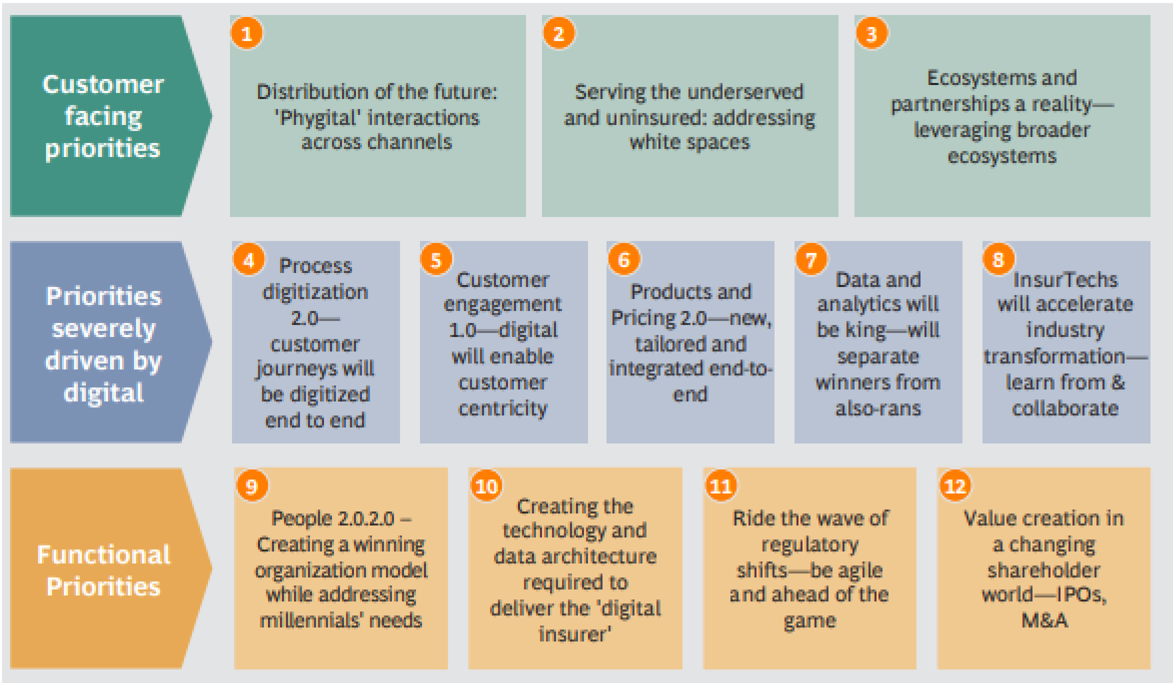
The functions of the IRDAI are defined in Section 14 of the IRDAI Act, 1999 and include:

- Issuing, renewing, modifying, withdrawing, suspending or cancelling registrations
- Protecting policyholder interests
- Specifying qualifications, the code of conduct and training for intermediaries and agents
- Specifying the code of conduct for surveyors and loss assessors
- Promoting efficiency in the conduct of insurance businesses
- Promoting and regulating professional organizations connected with the insurance and re-insurance industry
- Levying fees and other charges
- Inspecting and investigating insurers, intermediaries and other relevant organizations
- Regulating rates, advantages, terms and conditions which may be offered by insurers not covered by the Tariff Advisory Committee under section 64U of the Insurance Act, 1938 (4 of 1938)
- Specifying how books should be kept
- Regulating company investment of funds

- Regulating a margin of solvency
- Adjudicating disputes between insurers and intermediaries or insurance intermediaries
- Supervising the Tariff Advisory Committee
- Specifying the percentage of premium income to finance schemes for promoting and regulating professional organizations
- Specifying the percentage of life- and general-insurance business undertaken in the rural or social sector
- Specifying the form and the manner in which books of accounts shall be maintained, and statement of accounts shall be rendered by insurers and other insurer intermediaries.

Business and economics of insurance need for changing mindset and latest trends

Strategic Priorities for the Indian Insurers Customer



1. Distribution of the future – ‘Phygital’ interactions across channels:

So far, insurers had predominantly focused on leveraging digital for direct to customer interactions. In the immediate future, insurers will drive digital enablement and sophistication across all the distribution channels:

- Bionic agency: At present, the solicitation process is heavy on physical face-to-face interactions. Going beyond just sales, some of the potential elements of a bionic agency are enablement of agency force through mobile apps, agent interactions with the customers through digitally video tools, streaming demos and real time sales support from insurers.
- Open architecture banca partners: After many years of inactivity, open architecture bancassurance will become a reality. While insurers have established strong physical

distribution channels through bancassurance or other corporate partners, multi-channel integration across digital platforms including websites, apps is yet to achieve full maturity. The challenge is acute especially with brick and-mortar heavy partners such as PSU banks. In open architecture bancassurance, insurers that will effectively integrate with digital channels of the partners and leverage partners' customer data for customized offers will stand to gain a greater share of the pie.

- Direct digital interaction with customers: In the last few years, online insurance aggregators email and social marketing, search engine marketing and website tele-assist based direct sales have established themselves as key digital marketing and distribution channels. Growth witnessed in these channels leaves no doubt about their potential. By leveraging analytics and advances in technology and digital infrastructure, direct digital interactions and marketing to the customers will become highly personalized, more engaging and automated using natural language processing.

2. Serving the underserved and uninsured: addressing white spaces:

There are many customer segments that are under served, for example, the HNWI and mass market from a life insurance perspective, and the SME and mass market segments from a non-life insurance perspective. Let's talk about the mass market customers in detail. Insurers have traditionally found it difficult to target low-income customer segments or semi-urban, rural customer segments viably. Regulatory requirements as well as government schemes such as PMJBY or PMFBY have surely nudged insurers to target such segments but they have barely scratched the surface. The headroom for growth has always been there but lack of awareness among customers and low viability of distribution infrastructure did not translate the headroom into an addressable opportunity. The stars are now aligning and a number of drivers are set to change this picture. Ecosystems and partnerships will enable insurers to embed insurance offering in customer journeys. Aadhaar linked biometric authentication will ease the burden of fulfilling KYC requirements. Digital distribution, integration with ecosystems and partners will make insurance bite-sized and affordable.

Demonetization and PMJDY have bolstered financial savings and a good part of it will find its way to insurance products. Banca partners, which are aggressively targeting fee-income, will increase branch activation and use data and analytics to find the right targets. By any estimation, the 'opportunity' is large and it will play out only gradually. This will allow insurers to find their sweet spots, fine tune their business models and target significant growth for years to come.

3. **Ecosystems and partnerships a reality—leveraging the broader ecosystems**:

To create 'sustainable' differentiation, insurers will need to think of new business models that are hard to replicate and that engulf the customer across broad needs fulfilled by a suite of services. For example, creation of health ecosystem vs. health insurance, mobility ecosystem vs. motor insurance, retirement ecosystem vs. Pension plan, child care and development ecosystem vs. health insurance and so on. Ecosystems are a set of businesses, which address customer needs in a comprehensive and integrated manner.

For example, a health ecosystem will entail wellness providers, health food providers, fitness centres, primary clinics, diagnostic centres, secondary or tertiary hospitals, payers such as insurers / corporate / government, pharmacies, disease management services linked together by an ecosystem aggregator.

Ecosystems will help not only in gaining share of wallet but also in achieving customer ‘lock-in’ with more hooks and hence high exit barriers. Insurers will have to either take the lead and create such ecosystems or participate in existing ones. Since ecosystems business model is radically different from traditional insurance business model, it will require insurers to take large strategic bets, heavily invest in product design, operations and technology and source customers through multiple touch-points across the ecosystem.

4. Process digitization 2.0—customer journeys will be digitized end-to-end:

The global trend of digitizing the core insurance processes of sales, claims settlement as well as back-office operations is also gaining roots in India. A number of insurers have launched processes and apps for distribution partners and customers. Apart from productivity gains, digitization also helps improve process quality through standardization, process risk controls and lower manual involvement. For process digitization 2.0, insurers will leverage the rapidly developing digital infrastructure in the country as well as the latest technological advances. The next advance in process digitization will be driven by the following five key elements:

- **Aadhaar based biometric authentication**: Recent entrants in banking and Telecom have already leveraged Aadhaar based authentication to roll out fully paperless customer on-boarding process with high quality KYC compliance. Insurers have also started using the same. The time has come to commit to this unconditionally.
- **Digital document storage**: Whether it is de-materialized policy documents or claim documents, insurers have the opportunity to eliminate paper from most, if not all processes. However, to take full advantage, it will be imperative to have data architecture that allows capture of semi-structured and unstructured data. Third party digital lockers are now a reality where users can allow insurers to access paper records issued by other third parties such as government or medical records.
- **Digital consent**: Insurers in future will increasingly use third party data for tailored offerings, underwriting and customer service. Digitally signed consent through a modern private data-sharing framework will allow insurers to securely access specific data allowed by users. It will also enable separation of data and consent flow reducing the chance of frauds.
- **Digital payments**: Accelerating transition to cashless economy and adoption of UPI interface will significantly enable process digitization and eliminate manual elements of payment collections.
- **New technological advances**: Internet of Things (IoT) including wearable’s and telematic devices, Artificial Intelligence (AI) including chat-bots and machine learning, and Robotics will significantly increase automation leading to greater productivity.

5. Customer engagement 1.0—Digital will enable customer centricity:

Insurance as a product category faces a key challenge of limited customer touch-points and low customer engagement despite the consultative nature of the product and significant financial implications for the customers. BCG experience shows that insurers have on an average of 0.3-0.4 customer contacts per year. Add to that, the Indian situation where so far, insurers have focused more on intermediaries than the customers has resulted in even less data on end customers. Customer contractibility is abysmally low. Digital is a key enabler of disintermediation and allows insurers to meaningfully engage and influence customer experience directly. Insurance companies will have to start treating end customers as customers. They could potentially leverage the opportunity to integrate other high frequency transactions such as financial dashboards, health apps, social media content or other customer journeys (e.g. driving, travel, child education) and create ‘moments of truth’. The next imperative will be to excel at customer experience in those interactions. Insurers that will crack the code will surely have a better chance of increasing customers as well as share of customer wallet and retain customers for longer.

6. Products and pricing 2.0—new, tailored and integrated end-to-end:

In the rapidly evolving world, we believe that products will evolve on three key dimensions.

- **New products**—Evolving needs and growing niches will drive new product development and product feature enhancements. E.g. cyber risk, fine arts, extended warranty products will become more prominent.
- **Tailored offers**—based on data insights will make products uniquely relevant to the segment of one and pique customer interest. Better understanding of the customer profile and life stage, other financial transactions, social behaviour will allow insurers to provide the ‘right product at the right time’.
- **Products integrated with partner offerings**: Insurance is already sold through partnerships as an attachment product primarily in the context of loans or large asset purchases such as housing and vehicles. Even further, insurers will have the opportunity to introduce products with features that are highly customized or integral to the partner’s product offering. Product evolution will go hand in hand with evolving pricing approaches. Pricing will be a key driver of profitable growth. New data sources such as partnerships, IoT – wearable, big data analytics, will put insurers in a great position to bridge the ‘data divide’ and price products appropriately.

7. Data and analytics will be king and will differentiate winners from also-rans:

Like other businesses, insurers are also keen to leverage big data analytics. However, they suffer from lack of quality data. In India, the challenge is even starker, insurers struggle from lack of data, leave aside high quality data. It is driven partly by the nature of the business where customer transactions are limited (BCG analysis shows just about 0.3-0.4 contact points per year) and partly by the focus of insurers on intermediaries who call the shots and at times mask the data and do not share the full customer data with the insurers. In general insurance, for example, since KYC is not mandatory, insurers often do not have basic profile information of the customers. Importance of data is beyond debate and insurers can overcome the challenge by first looking internally for the right processes to capture the appropriate data as well as look at forging data partnerships. Different data partnerships become relevant in the context of sourcing and actuarial modelling. In case of sourcing, insurers need to dig deeper into sourcing data from intermediaries apart from third party partnerships which provide rich information on customer profile, life stage, social behaviour and transaction context. In case of actuarial modelling, varied sources of data can be leveraged in specific contexts.

8. **Insure Techs will accelerate industry transformation – insurers will learn from and collaborate with them**:

Insur Techs have been late in coming to the start-up party, but come they have with vengeance. While Insur Techs started later than Fin Techs, over the past few years, ~2,100 InsurTechs have received investments in excess of $38 Bn. Nearly 600 Insur Techs have come up in last 5 years.

Technology driven start-ups are driving a range of innovations across the value chain. From new pricing models (pay as you go - Metromile), to peer-to-peer insurance (friendsurance, Kroodle), to connected devices/drones for real time information collection for underwriting, claims settlement (dropin, domotz), the list is long and each of these players is disrupting the insurance space. InsurTechs will challenge insurers by completely transforming and disrupting business models. At the same time, many of them will provide an opportunity for insurers to collaborate and differentiate on underwriting, claims and customer service. Traditional operating models and organization structures of insurance companies do not allow for an entrepreneurial approach required for disruptive innovations in products and processes. Insurance companies will need to explore the opportunity to groom the InsurTechs through separate incubators and innovation labs that isolate the innovation effort from the traditional way of working. Incubators allow insurers to engage with start-ups meaningfully in win-win situations where the parent business brings the seed capital, business experience and customer base strength, whereas the start-ups bring fresh ideas that businesses can nurture for their own advantage.

9. People 2.0.2.0.—Creating a winning organization model while addressing millennials' needs:

Millennials will be a sizeable part of the workforce by year 2020. Insurers (as will all businesses) will need to dapt to the new way of working to deliver the 'Future of Work'. Over the generations, one can observe the mindset shifts, 'from one job per lifetime to one career per lifetime to the millennials' comfort with a few careers and multiple jobs'. A large shift is visible in the workforce values and culture. As loyalty takes a new meaning, organizations will need to focus on talent management on steroids to manage talent gaps, focus on individualization and entrepreneurship and address the changing employee needs. Complexity is also compounded by the impact of technology on the people dimension.

10. Creating the technology and data architecture required to deliver the 'digital insurer':

Infomation Technology has been the backbone of many transformations within the Insurance industry over the past two decades. However, the past two decades will not be a patch on the next few. The multiple state-of-the-art technology advances from big data and analytics, to machine learning and artificial intelligence, to the Internet of Things including wearables and telematics, to robotics, to chatbots, to voice recognition and beyond, will completely transform the requirements from IT architecture. Agile, a very small five alphabet word, will drive the technology teams crazy. Let's take just two of these advances as examples, AI and Big Data. Until recently, AI was similar to nuclear fusion, an unfulfilled promise. It had been around for a long time but had not reached the spectacular heights foreseen in its infancy. Now, however, AI is realizing its potential in achieving human-like capabilities, so it is the time to ask: "How can business leaders harness AI to take advantage of the specific strengths of man and machine?"

There are three implications for the insurers.

- AI sounds ‘cool’ but insurers will need to define clear business use cases. Fundamentally, AI will need to address customer needs in an efficient manner
- Breaking down processes and offerings into relatively routinized and isolated elements that can be automated taking advantage of technological advances and data sources. Then, reassembling them to better meet the customers’ needs
- Incorporating technological advances – The stack of AI services has become reasonably standardized and is increasingly accessible through intuitive tools. Even non-experts can use large data sets. Right platforms and tools need to be setup for flexible architecture and for integration with diverse process elements.

As insurers prepare themselves to leverage Big Data either by harnessing data that is available internally or through partnerships, they need to assess the preparedness to manage such data. Traditionally, insurers have been used to managing structured data that comes as part of various business processes.

Harnessing new sources of data will require the ability to store and process semi-structured and unstructured data such as customer interactions, images, medical records. Multiple trade-offs including costs, speed, functionality, scalability, data diversity are involved while choosing the right data architecture in line with business objectives. Given the selection and implementation lead times, this becomes not only important but also urgent for parallel design and execution of business strategy.

11. Ride the wave of regulatory shifts – be agile and ahead of the game:

In case of the insurance industry across the globe, regulatory changes have always had large implications for insurers. As one looks ahead, the regulatory environment will continue to be dynamic because of the business environment changes, such as new business models like the ecosystems mentioned above, new products driven by partnerships and customer data insight, heightened risks such as cyber security and data privacy. Insurers will need to keep pace with the evolving regulations.

Take for example, the GST rollout, which is likely to happen this year. This will have a huge implication for insurers on multiple fronts, including attractiveness of product categories, and the operational efforts for insurers. The applicability of different GST slabs can significantly influence affordability and therefore alter the growth trajectory of different product segments. Insurers will need to work with the regulatory body to ensure that regulations, while aligned with the principles, are also practical in terms of the implement ability, the impact on customers and the business economics.

12. Value creation in changing shareholder world:

A number of the insurers will have to deal with new shareholders over the next few years. In fact, likely all of them. Two big trends driving this – the listing of insurers, including the PSUs and the accelerating wave of M&A. Retail investors (driven by listing), new strategic investors (basis M&A) and potential PE investors are all going to completely transform shareholder expectations. The scrutiny on the insurers as well as the many metrics will change drastically.

Typically, not only value creation, but also consistency of the same (beta) is key for investors. Insurers will have to manage these new shareholder expectations. In closing, each of the insurers will need to define their own agenda and priorities basis the 12 strategic priorities outlined above. The journey to deliver a sustainable business in the face of all the change will not be easy. Insurers will need to place their bets on the most relevant priorities for them in the context of their business model and pursue them with conviction.

Unit V: INTRODUCTION TO RISK MANAGEMENT

5.1. Introduction to Risk

Risk management is formally defined as the process by which an organization assesses and addresses its risks. Historically, the role of risk management has been associated with insurance-buying, occupational safety and health, and legal liability management. In recent years managers and physicians alike have begun to recognize that organizational risks are pervasive, that these risks are extraordinarily diverse and complex, and that these risks are not just confined to "insurable" or accident-related situations. They may include risks arising from actions of regulatory bodies, third party payers, hospitals, partners, and employees, in addition to the physiatrist's personal or business investment, management and clinical practice. Furthermore, changing customer and patient preferences and/or expectations make the assessment of risk an even more dynamic and continuous process. This article describes the formal risk management process and suggests ways that physiatrists can apply risk management to their business and clinical practice. In developing this description, physiatrists and their office managers will learn about the overall goals and objectives of risk management, the challenge of identifying and analyzing risks, the tools and treatment options available, and the means by which risk management efforts are effectively implemented.

Literally speaking, **risk management is the process of minimizing or mitigating the risk**. It starts with the identification and evaluation of risk followed by optimal use of resources to monitor and minimize the same.

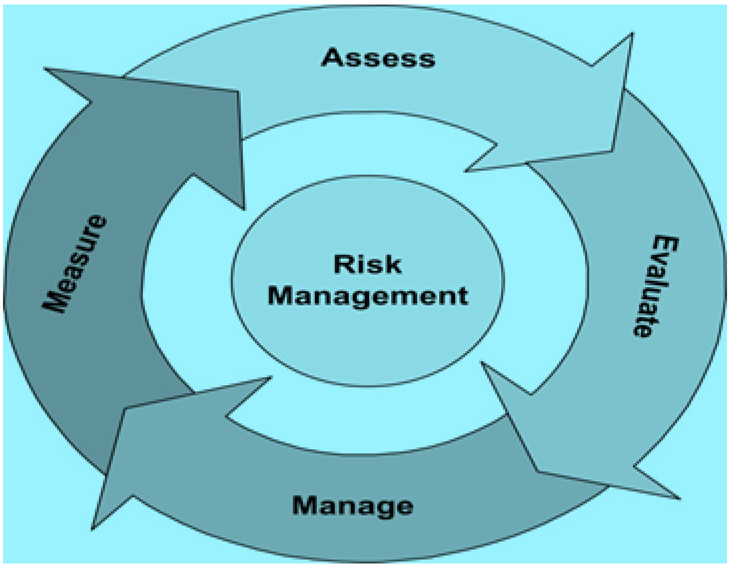
Risk generally results from uncertainty. In organizations this risk can come from uncertainty in the market place (demand, supply and Stock market), failure of projects, accidents, natural disasters etc. There are different tools to deal with the same depending upon the kind of risk.

Ideally in risk management, a risk prioritization process is followed in which those risks that pose the threat of great loss and have great probability of occurrence are dealt with first. Refer to table below:

IMPACT	**ACTIONS**		
SIGNIFICANT	Considerable Management Required	Must Manage and Monitor Risks	Extensive Management essential
MODERATE	Risk are bearable to certain extent	Management effort worthwhile	Management effort required
MINOR	Accept Risks	Accept but monitor Risks	Manage and Monitor Risks
	LOW	**MEDIUM**	**HIGH**
	LIKELIHOOD		

The above chart can be used to strategize in various situations. The two factors that govern the action required are the probability of occurrence and the impact of the risk. For example a condition where the impact is minor and the probability of occurrence is low, it is better to accept the risk without any interventions. A condition where the likelihood is high and the impact is significant, extensive management is required. This is how a certain priority can be established in dealing with the risk.

Apart from this, typically most of the organizations follow a risk management cycle. Refer diagram below:



According to this cycle there are four steps in the process of risk management. The first step is the assessment of risk, followed by evaluation and management of the same. The last step is measuring the impact.

Risk identification can start at the base or the surface level, in the former case the source of problems is identified. We now have two things to deal with the source and the problem.

Risk Source: The source can be either internal or external to the system. External sources are beyond control whereas internal sources can be controlled to a certain extent. For example, the amount of rainfall, weather over an airport etc!

Problem: A problem at the surface level could be the threat of accident and casualty at the plant, a fire incident etc.

When any or both of the above two are known beforehand, certain steps can be taken to deal with the same.

After the risk/s has been identified then it/they must be assessed on the potential of criticality. Here we arrive upon risk prioritization. In generic terms ‘likelihood of occurrence × impact’ is equal to risk.

This is followed by development of a risk management plan and implementation of the same. It comprises of the effective security controls and control mechanisms for mitigation of risk.

A more challenging risk to organizational effectiveness is the risk that is present but cannot be identified. For example a perpetual inefficiency in the production process accumulates over a certain period of time and translates into operational risk.

5.2. Meaning and types of risk in business

Business risk can be defined as uncertainties or unexpected events, which are beyond control. In simple words, we can say business risk means a chance of incurring losses or less profit than expected. These factors cannot be controlled by the businessmen and these can result in a decline in profit or can also lead to a loss**.**

Nature of Business Risk

Business risk is the possibilities a company will have lower than anticipated profits or experience a loss rather than taking a profit. Business risk is influenced by numerous factors, including sales volume, per-unit price, input costs, competition, and the overall economic climate and government regulations.

1. Arises due to Uncertainties

Uncertainties mean when you are not sure of what is going to happen in future. Common examples of uncertainties are: change in demand, government policy, technology etc. Business risk is due to these uncertainties.

2. Essential part of any Business

A risk is an important characteristic of business. No business can avoid risk although the degree of risk may vary Risk can be reduced but cannot be eliminated.

3. Degree of Risk Depends upon the Nature and Size of Business

The degree of risk depends upon the type of business; for example, a business involved in fashion items bears more risk as compared to the business involved in standardized goods. Similarly, a business operating at large scale bears more risk as compared to small-scale business houses.

4. Profit is the Reward for bearing the Risk:

The business earns a profit because they are bearing risk.”No risk no gain” larger the risk more is the profit. An entrepreneur bears risk with the expectations of earning a profit.

Causes of Business Risk

Natural Causes

Nature is an independent phenomenon and human beings have no control over it. Natural calamities like earthquake, flood, drought, famine etc. Affect a business a lot and can result in heavy losses. The natural causes are such type of uncertain factors that human beings cannot make any preparation against.

Human Causes

Human causes are related to a chance of loss due to human being or employees of the organization. The dishonesty of employees can bring heavy losses for business e.g., the employees may leak a business secret to a competitor and may commit fraud also bring heavy losses by wastage of resources.

The employees may hamper the production by going on strikes, riots etc. This can also lead to heavy loss of business condition. There can be price fluctuations in the market, there can be a change in fashion, taste, preferences, and demands of customers

Economic Causes

Economic causes are related to a chance of loss due to change in the market. There can be a change in the degree of competition. All these have a direct impact on the earnings of the business.

Even change in Government policy affects the business a lot. For example, in 1971 when Janata government came to power the Coca-Cola Company and many other foreign companies were sent back to India

Physical Causes

All the causes which result in damage of assets are considered as a physical cause, for example, change in technology may result in machinery being outdated, use of old technology, mechanical defects may also result in damage of assets such as the bursting of a boiler, accident to employee etc.

Types of Business Risk

The business risk can be classified into two major categories:

Insurable Risk

The risks which can be recovered are called insurable risks. The losses which can be made good or losses for which company can get compensation from the insurance company are called Insurable Risks. Generally, the natural and physical risks are insurable risks, e.g., businessmen can take a fire insurance policy to get protection from flood, earthquake or from the damage of assets such as the bursting of boiler etc.

Non-insurable Risks

The risks for which no protection is available are called Non-insurable risks. The businessmen cannot get compensation for a change in demand or loss due to negligence or carelessness of employees. Whether the risk is insurable or non-insurable, only the loss can be shared but the risk remains

Minimization of Risk

Business has many risks but it can also be avoided by adopting some measures. Management can adopt the technique to minimize the chance of occurring any particular event which form may cause the loss. All the risks cannot be avoided but these can be minimized.

So such policies are adopted which reduce the loss. For example, there is a greater risk to send the product by air then by train. So the risk can be reduced by sending the product by train. Similarly, when you introduce a new product, there is a greater risk, so you may refuse to avoid the risk.

Though a firm can never escape from a presence of any risk it can still employ methods to avoid them. For instance, the firm can:

1. Avoid itself from entering into a risky transaction;
2. Preventive measures can be taken like firefighting;
3. Transfer the risk to an insurance company by taking a policy:
4. Share risk with other enterprises by making the manufacturers agree to compensate the losses in the case of falling prices.

Principles of Risk Management

Various organizations have laid down principles for risk management. There are risk management principles by International standardization Organization and by Project Management Body of Knowledge.

The Project management body of knowledge (PMBOK) has laid down 12 principles. This article carries an amalgamation of both PMBOK and ISO principles.

The various principles are:

1. **Organizational Context**: Every organization is affected to varying degrees by various factors in its environment (Political, Social, Legal, and Technological, Societal etc).

   For example, an organization may be immune to change in import duty whereas a different organization operating in the same industry and environment may be at a severe risk. There are also marked differences in communication channels, internal culture and risk management procedures. The risk management should therefore be able to add value and be an integral part of the organizational process.

2. **Involvement of Stakeholders**: The risk management process should involve the stakeholders at each and every step of decision making. They should remain aware of even the smallest decision made. It is further in the interest of the organization to understand the role the stakeholders can play at each step.

3. **Organizational Objectives**: When dealing with a risk it is important to keep the organizational objectives in mind. The risk management process should explicitly address the uncertainty. This calls for being systematic and structured and keeping the big picture in mind.

4. **Reporting**: In risk management communication is the key. The authenticity of the information has to be ascertained. Decisions should be made on best available information and there should be transparency and visibility regarding the same.

5. **Roles and Responsibilities**: Risk Management has to be transparent and inclusive. It should take into account the human factors and ensure that each one knows it roles at each stage of the risk management process.

6. **Support Structure**: Support structure underlines the importance of the risk management team. The team members have to be dynamic, diligent and responsive to change. Each and every member should understand his intervention at each stage of the project management lifecycle.

7. **Early Warning Indicators**: Keep track of early signs of a risk translating into an active problem. This is achieved through continual communication by one and all at each level. It is also important to enable and empower each to deal with the threat at his/her level.

8. **Review Cycle**: Keep evaluating inputs at each step of the risk management process - Identify, assess, respond and review. The observations are markedly different in each cycle. Identify reasonable interventions and remove unnecessary ones.

9. **Supportive Culture**: Brainstorm and enable a culture of questioning, discussing. This will motivate people to participate more.

10. **Continual Improvement**: Be capable of improving and enhancing your risk management strategies and tactics. Use your learning’s to access the way you look at and manage ongoing risk.

5.3. Individual Risk management process

Risk Management Process

There are several bodies that lay down the principles and guidelines for the process of risk management. The steps involved remain the same more or less. There are small variations involved in the cycle in different kinds of risk.

The risks involved, for example, in project management are different in comparison to the risks involved finance. This accounts for certain changes in the entire risk management process. However the ISO has laid down certain steps for the process and it is almost universally applicable to all kinds of risk. The guidelines can be applied throughout the life of any organization and a wide range of activities, including strategies and decisions, operations, processes, functions, projects, products, services and assets.

As per ISO 31000 (Risk Management - Principles and Guidelines on Implementation), risk management process consists of the following steps and sub-steps:

- Establishing the Context
- Identification
- Assessment

Establishing the Context: Establishing the context means all the possible risks are identified and the possible ramifications are analyzed thoroughly. Various strategies are discussed and decisions are made for dealing with the risk. The break-up of various activities in this stage is as follows:

- Identification of a risk in one particular domain.
- Planning out the entire management process.
- Mapping the manifestations of the risk, identification of objectives of risk etc.
- Outlining a framework.
- Designing an analysis of risks involved at each stage.
- Deciding upon the risk solution/s.

Identification: Once the context has been established successfully, the next step is identification of threats or potential risks. This identification can be at the level of the source or the problem level itself.

Source analysis means that the source of risks is analyzed and appropriate mitigation measures are put in place. This risk source could be either internal or external to the system. Examples of the risk source could be employees of the company, operational inefficiency in a certain process etc.

Problem analysis on the other hand means the effect rather than the cause of the risk is analyzed. For example a drop in production, threat of losing money etc!

The choice of the method varies across industry, organizational culture and other factors. However some common methods of risk identification are:

- **Taxonomy based Risk Identification**: The possible risk sources are broke down, hence taxonomy. A questionnaire is made best on existent knowledge; the answers to the questions are the risk.
- **Objective based Risk Identification**: An organization or any business activity has a certain objective/s. Any activity that is deemed an obstacle in the achievement of the same is perceived as risk.
- **Scenario based Risk Identification**: Here various scenarios, which may be alternative ways to achieve an objective, are created. If an undesired scenario is created, a threat is perceived with the same.
- **Common Risk Check**: There are certain risks that are common to an industry. Each risk is listed and checked on time.

Assessment: Once the risks have been identified, they are then assessed on their likelihood of occurrence and the impact. This process can be simple as in case of assessment of tangible risks and difficult like in the assessment of intangible risks. This assessment is more or less a guessing game and the best educated guess decides the success of the plan**.**

The industry practice or formula for arriving upon the risk is:

Frequency of occurring × Impact

5.4. Individual Risk management methods

Personal Risk

Personal risk is anything that exposes you to the risk of losing something of value. Usually, personal risk is associated with your financial investments and insurance. These investments may be in the stock market, mutual funds, or loans to others. The insurance may be in the form of liability insurance. Whenever you take on any of these investments, you stand a certain amount of risk in losing your money. And when you are in business for yourself, you expose yourself to a certain amount of liability as you provide products or services to others. Especially when it comes to liability insurance, if you aren't insured properly, you could be sued and lose out on a lot. In this lesson, we will talk about ways to manage these risks.

Let's follow Bob as he reviews some ways he can manage his personal risk. Bob has investments in the stock market in various industries and various companies. Bob also has his own hamburger restaurant. He has liability insurance to protect himself in case anybody gets sick eating one of his hamburgers or falls on his premises.

Risk Assumption

Bob has taken on a certain amount of risk assumption by investing in the stock market and in opening his own hamburger restaurant. Risk assumption is when you willingly and knowingly take on a certain level of risk. Whenever you make any kind of investment in the stock market, you will be presented with a document explaining the risks you are knowingly entering into. This is your risk assumption when you make such an investment. It is the same when you open up a restaurant. Although there is no formal paperwork, it is understood that when you have a business that interacts with others, you have accepted the risk assumption of operating such a business. It is your responsibility then to purchase the necessary liability insurance to cover you and your business.

Bob understands that when he invests in the stock market, he can lose all of his money. Also, Bob knows that when he operates his hamburger restaurant, he is liable for anyone who gets sick from eating his hamburgers and for anyone that gets hurt on his property. This is the risk he has taken on with his risk assumption and this is the risk he needs to manage.

Risk Avoidance

One way that Bob can manage this risk is by practicing risk avoidance. This is when you do your best to eliminate any hazards or activities that can negatively impact you. For example, if you know that taking a certain road when it’s raining increases your chance of getting into an accident, then avoiding that road when it’s raining will decrease the risk of you getting into an accident.

For Bob, it means using only his extra disposable money to invest in the stock market so he doesn't risk losing the money he needs to use. For his personal business, it means making sure his food is always fresh and his property is always clean with possible trip hazards clearly marked with safety bars in place.

Risk Shifting

Yet another method Bob can use is that of risk shifting. This involves paying someone else to take on your risk for you. The biggest question here is who would want to do this? The answer is actually quite a lot of people. Insurance is an example of someone taking on your risk for you. You just have to pay them a certain amount each month. For example, purchasing health insurance puts the responsibility of paying medical bills on your insurance company.

For Bob, risk shifting would mean Bob can purchase liability insurance for his hamburger restaurant. If anyone gets sick from eating his food or gets hurt while at his restaurant, then it becomes the responsibility of his liability insurance company to pay for the medical care of the person who got sick or hurt. His liability insurance company has taken on the risk of Bob operating his hamburger restaurant.

5.5. Risk identification

Risk Identification and Assessment

The organizational game is changing fast these days. The HR manager today acts as an associate with line management to crack important business issues. We therefore, have the emergence of Business HR function these days.

One of the most common factors in all organizations these days is the change. This change brings with it - risk. It is therefore imperative on the part of human resource managers to be aware of these risks.

Risk managers today are increasingly one in their opinion regarding the intervention of HR in the management of risk. For good reason the HR people are partnering their skills with people in the risk management department.

But how exactly do HR people play a role in risk management? Let's assume that there is a drop in production steadily that has come to the notice of top management. The HR manager having identified the risk i.e. the drop in productivity goes on to locate the human element of the problem. The risk may be on account of a deviation between what should be done operationally and what is being operationally.

Once the risk has been identified the HR manager approaches the line managers and their staff and questions them to assess and prioritize the risk. Finally the HR manager strategizes to deal with the risk, if need be. One of the possible interventions is offering training to the staff. This is one of the ways in which the Human resource people play a vital role in risk management.

Performance Consulting: The relationship between the HR executive and strategic and operational business managers is talked about in performance consulting. Performance consultants work in close alliance with managers and other people within the organization. Their primary task is to work alongside and gain the trust of managers i.e. promotes trust relationships among managers. These partnerships are formed between various groups in the organization like senior managers, line managers and supervisors, top leadership and subject experts. They also promote partnerships with customers and suppliers.

As we know that risk management consists of risk identification, assessment, analysis and prioritization. The HR executive plays a significant role in risk control as well. Risk avoidance is one of the ways to deal with risk. Since the HR managers intervene only in the human element of the risk. Risk control measures here would include succession planning, executive coaching and development, all this to ensure that an organization is equipped adequately to deal with the risk.

Further, in risk management the HR executive plays a vital role in identifying attributes for important positions or executives within the organization. Training, developing and coaching people within the organization so as to increase their work ownership and increasing their morale for the future positions; employee turnover is also a potential risk from HR standpoint.

5.6. Risk Measurement

Various Aspects of Risk Management

What does risk management mean? Is it just identification, assessment and planning and controlling social, economic or physical threat to the organization? Is the concept only about transferring the risk or reduce its negative effects?

Well, the answers for the above questions is “no”. The process of risk management is not only restricted to controlling the threats or reducing their negative effects. It is a much deeper concept that also involves risk avoiding as well as risk taking. Every work involves some or other kinds of risk. Sometimes you avoid, sometimes you control the phenomenon and sometimes you simply let it come. Same is true for the business world.

The idea behind is that there are no hard and fast rules. This means that even though we have a systematic approach to treat risk it is not necessary that this is going to help. Simply designing and implementing a risk management plan is not enough to treat risk. It depends on firm-to-firm and industry-to-industry. There are various other criteria that need to be analyzed such as internal and external environment of a company, company’s ability to develop and implement a risk management plan effectively.

There are various other issues that need to be addressed. Before you spend your time, efforts and money, see if you really require a full-fledged risk management plan to control the financial, physical or social threat to the organization. Deeply examine your requirements and need to treat the risk. Sometimes, avoiding risk is considered as the best strategy.

When you decide about a risk management plan, you need to examine thoroughly and ask yourself few questions before proceeding further. These questions act as an eye opener and provide you with the outline of what you need to do and what to look at. Read further to know what you should ask yourself while designing, developing, implementing or reviewing your risk management plan:

Do You Actually Need a Plan: This is first and the foremost question that you need to ask yourself. Thoroughly examine the situation and decide if you actually need a risk management plan.

Is the Plan Feasible: This is really important to checkout if the prepared risk management plan is feasible or if it is possible to bring it to life. Also check if it suits your requirements or not.

What Are the Strengths and Weaknesses of a Risk Management Plan: Conduct a SWOT analysis and try to find out the strengths and flaws in the plan. Remove the flaw beforehand so that you get desired results after implementing it.

Does It Meet Your Objectives: The biggest requirement for a risk management plan to be successful is that it should meet your company's objectives. Try to match the firm's objectives with plan's objectives.

Analyze If Risk Needs to be Treated: Carefully examine if you can avoid the risk or not. There is no need to develop a full-fledged plan if you think you can avoid it. It is not at all necessary to treat the risk always. It depends on the severity of a situation.

Check If a Plan is Backed By Clearly Defined Activities and Events: A risk management plan should always be backed by clearly defined activities and events otherwise it may cause problems in long run.

The golden rule for the success rule of a risk management plan is that there is no golden rule. Each firm is different and faces different types of risks in different business environments. You need to develop a unique plan for your firm to manage the risks efficiently and effectively.

Creation of Risk Management Plan:

Any project immaterial of the size of the same carries a lot of risks, which may be financial, non-financial, legal or physical. Having an effective risk management plan is first and foremost to the success of any project. The task is to anticipate these risks well in advance before the project takes off.

A good risk management plan carries number of tools and strategies to mitigate risk. The strategy may be to avoid risk or transfer a component of it another project so that the impact is reduced.

Other risk management strategies may suggest the acceptance of the risk. This is decided after a thorough cost/benefit analysis. The risk management plan also depends on how the risks are prioritized by the organization. Based on relative priorities risks are given weightage, for example a certain organization may be more concerned about the physical and legal risks, whereas another organization may be focusing on operational or strategic risks. Risk priority defines the strategy and finally the plan.

Besides keeping the risk management cycle in mind; before the final draft, an effective risk management plan may traverse through following:

Make a List: Before starting or deciding on anything else it is important to make a list of potential risks. Even the minutest details need to be taken care of. Something that appears a minute threat now may transform into a potential risk in the near future. This is especially true for project management. Enlist the categories of the project and then evaluate each for risks. For example there may be a cost category; determine the factors that may increase cost and make a list.

Prioritize the Risks: Arrange the risk in order of priority. Those that need to be dealt with first are listed first. Risks are prioritized on the basis of degree of impact and the likelihood of occurrence.

Developing and Action Plan: Plans are designed to minimize the impact of the risk and to check the occurrence. In addition, an action plan in developed against each risk i.e. in event of occurrence how do we respond to the risk, who all will be responsible and what are the contingencies.

Human Resource Deployment: Now people are deputed at specific points with specific roles. They work in tandem with the entire team and are specially deployed to undertake planned actions in case the anticipated risks come true. These actions are to be taken at specific points in time; a timeframe is necessary.

Communication: Finally, communication of the plan to stakeholders (both internal and external becomes necessary). Present the plan to those who are supposed to make key interventions. Explain the timeframes and the actions and the responsibilities.

The formulation of the plan is in tandem with the risk management cycle which acts as the basic guideline. Both works in sync, in fact the interventions in step 3 discussed above cannot be without a thorough understanding of the cycle.

Evaluation of a Risk Management Plan

A risk management plan can never be perfect. However, the degree of its success depends upon risk analysis, management policies, planning and activities. A well-defined management plan can be successful only if risks are properly accessed. And if not, the main objective of risk management plan itself is defeated. Critical evaluation of a risk management plan at every stage is very necessary especially at an early stage. It will allow companies to discover the flaws before it gets into the action. Once you’re through the process, you can address the issues and then introduce it.

The below mentioned steps can help in analyzing and evaluating a risk management plan:

Problem Analysis: Keep a note of all the events and activities of a risk management plan. Check out the problems arising from their implementation and assess if they have a serious impact on the whole process. Make a note of those that have serious implications.

Match the Outcomes of a Risk Management Plans with its Objectives: Ends justify means. Check if the possible outcomes of a risk management plan are in tandem with its pre-defined objectives. It plays a vital role in analyzing if the plan in action is perfect. If it produces desired results, it does not need to be changed. But if it fails to produce what is required can be a really serious issue. After all, an organization deploys its resources including time, money and human capital and above all, the main aim of the organization is also defeated.

Evaluate If All the Activities in the Plan are Effective: It requires a thorough investigation of each activity of a risk management plan. Checking out the efficiency of all the activities and discovering the flaws in their implementation allow you to analyze the whole plan systematically.

Evaluate the Business Environment: A thorough study and critical evaluation of business environment where a risk management plan is to be implemented is essential. Take time to access, analyze and decide what exactly is required.

Make Possible Changes in Faulty Activities: After evaluating the effectiveness and efficiency of all the activities, try to make possible changes in the action plan to get desired results. It may be very time consuming but is necessary for successful implementation of your risk management plan.

Review the Changed Activities: After making changes in already existing activities and events of a risk management plan, go for a final review. Try to note down the possible outcomes of the changed activity and match them with the main objectives of the risk management plan. Go ahead in case they are in line with them.

Evaluating a risk management plan sometimes can be very frustrating. It is definitely a time consuming process and also requires more of human efforts. Therefore, it is always better to analyze and evaluate a plan at every stage otherwise it will result in wastage of time, finances and efforts. In order to keep a check on it, specialized teams of risk managers can be appointed. The whole event can be outsourced to a risk management firm. The professionals at the firm can help you design, develop, implement and evaluate a risk management plan for your company.

5.7. Risk management techniques

FUNDAMENTAL TECHNIQUES OF RISK CONTROL

1. **Avoidance**

Avoidance is the best means of loss control. This is because, as the name implies, you're avoiding the risk completely. If your efforts at avoiding the loss have been successful, then there is a 0% probability that you'll suffer a loss (from that particular risk factor, anyway). This is why avoidance is generally the first of the risk control techniques that's considered. It's a means of completely eliminating a threat.

Avoidance should be the first option to consider when it comes to risk control. For example, if you are transferring sensitive data from one location to another, you can avoid the risk of having it stolen if you don't leave it in your car overnight. Another, perhaps more obvious example, is paying clients with checks rather than mailing cash.

2. **Loss Prevention**

Loss prevention is a technique that limits, rather than eliminates, loss. Instead of avoiding a risk completely, this technique accepts a risk but attempts to minimize the loss as a result of it. For example, storing inventory in a warehouse means that it is susceptible to theft. However, since there really is no way to avoid it, a loss prevention program is put in place to minimize the loss. This program can include patrolling security guards, video cameras, and secured storage facilities.

3. **Loss Reduction**

Loss reduction is a technique that not only accepts risk, but accepts the fact that loss might occur as a result of the risk. This technique will seek to minimize the loss in the event of some type of threat. For example, a company might need to store flammable material in a warehouse. Company management realizes that this is a necessary risk and decides to install state-of-the-art water sprinklers in the warehouse. If a fire occurs, the amount of loss will be minimized.

4. **Separation**

Separation is a risk control technique that involves dispersing key assets. This ensures that if something catastrophic occurs at one location, the impact to the business is limited to the assets only at that location. On the other hand, if all assets were at that location, then the business would face a much more serious challenge. An example of this is when a company utilizes a geographically diversified workforce.

5. **Duplication**

Duplication is a risk control technique that essentially involves the creation of a backup plan. This is often necessary with technology. A failure with an information systems server shouldn't bring the whole business to a halt. Instead, a backup or fail-over server should be readily available for access in the event that the primary server fails. Another example of duplication as a risk control technique is when a company makes use of a disaster recovery service.

6. **Diversification**

Diversification is a risk control technique that allocates business resources to create multiple lines of business that offer a variety of products and/or services in different industries. With diversification, a significant revenue loss from one line of business will not cause irreparable harm to the company's bottom line.

Risk control is a key component in any sound company strategy. It's necessary to ensure long-term

7. Retaining the Risk

Sometimes it's preferable to keep your level of risk as it is because the cost of avoiding the risk is more than the cost of damage or loss. Often, we retain risk without even thinking about it. For example, if you have $100 in petty cash in a locked drawer in your office, there is always the chance someone could steal it. However, the cost of a wall safe would greatly exceed the amount of money you would be protecting.

8. Spreading the Risk

Spreading the risk is often an inexpensive way of reducing the chances of a calamity. To protect digital information, for example, it's a common practice to back up computer storage. This protects the data from a drive error, viruses and malware. Moving the back-up drive to a separate building spreads the risk even more thinly, protecting the data from physical theft or a fire in one building. Companies with extremely valuable data often spread the risk even further by putting a copy of the data in a different city.

9. Preventing or Reducing Loss

When exposing yourself or your company to risk is unavoidable, you can often reduce or eliminate losses by taking safeguards against it. For example, if you own a hardware store, it's unlikely that you can eliminate the chance of theft when your store is closed for the night. However, purchasing an alarm system may be enough to make potential thieves avoid breaking in at night. If they do break a window, having an alarm sound and having the police dispatched to your store would reduce the amount the thieves could steal before they would be forced to flee.

10. Transferring the Risk

Transferring risk should usually be the last risk management technique you should use. Two common examples include transferring the risk to another party in a contract and the purchase of insurance. For example, a delivery company may contractually transfer the risk of damage to packages to either the shipper or the receiver. A second way this company could transfer the risk is by purchasing insurance so that if a package is damaged, the insurance company absorbs the loss.

Developing Risk Management Strategies

Every business has a unique set of risks, which can vary from year-to-year and even from one project to another. One method of managing risk and determining which strategies you should use is to list the potential risks, rate the probability of them occurring and then to decide which strategy is best to deal with each one.

In most cases, you should be able to use a combination of experience along with industry data to determine the likelihood of a risk. Of course, relying solely on experience in itself will seldom give you accurate data. If you're constructing a new building, for example, there is usually some risk of flood damage in the future. Just because there has not been a flood in recent years does not mean a flood is unlikely. Even if U.S. Geological Survey data indicates, there is only a 1-percent chance of a flood that equates to a 26-percent chance over the next 30 years.

5.8. Non insurance methods

Non-Insurance methods in Risk Management –

- There are various methods available in non-insurance methods of Risk Management.
- They are –
    1. Risk Avoidance
    2. Loss Control
    3. Risk Retention Let us now, study each of them

1. Risk Avoidance –

- It means, avoiding the activities where the risk in involved.
- Generally, a firm will abandon the activities or assets that will lead to loss.
- This technique is applied when the risk is known or loss is already known and it is not serious in nature.
- There are two types of Risk Avoidance - (I) Risk Transfer and (II) Risk Aversion

(I). Risk Transfer	• It it simply selling of asset where the risk is involved, thereby we are transferring the risk to another owner • We say that, transfer of ownership of asset will reduce the risk associated with it.
(II) Risk Aversion	• It is a situation where an individual chooses the lesser risks involved projects from available other projects. • We can define it as - "investor gives preference to less risky investment projects when compared to other projects though they are identical in rate of returns".

2. Loss Control –

- Loss Control refers to techniques adopted by organizations to control the unavoidable risks.
- They control by adopting techniques like loss reduction, loss prevention etc.
- There are three types of Loss Control –

(I). Severity Reduction	• Here the focus is on reduction of Severity of losses
(II). Separation	• It will focus on reducing the amount of loss associated with Specific Risks.
(III). Duplication	• Here, a firm makes an arrangement of duplicate equipments to replace the damaged ones. • This is more used in production units to minimize the loss caused by Equipment damage.

- Loss Control becomes a major factor in decision making for a risk manager either in investment or loss reduction prospects.
- Benefits of Loss Control –

  A. Reduction of losses

  B. Over all of cost of risk management will reduce

  C. Better Decision making

  D. Helps to take right decisions on projects

  E. This helps more in cases where the exact risks cannot be expressed in monetary terms.

3. Risk Retention –

- Here the firm, retains the part of losses or all the losses that are resulting from risk exposure. (Firm bears the losses)

- The losses are paid off from firm’s net income or funds etc.
- This technique is mostly used by Large organisations
- Types of Risk Retention

Planned Retention	• Here the risk is already identified, and then appropriate plans and efforts are for assumptions of such risks. • Most convenient technique for risk management.
Unplanned Retention	• Here risk retention without recognition of Exact Risk involved.
Unfunded Retention	• No funds are made available to cover up losses
Funded Retention	• Funds are made available in advance to cover up the losses. • **It is done so by,** - using credit, Reserve Funds, Self-Insurance, and Captive Insurance. • **Under self-Insurance**: some fixed amount of funds is already made available for losses incurred from risk and does not involve in transfer of assets. • **Under Captive - Insurance**: Firm follows both risk retention and risk transfer techniques. Here the Payment of losses is made by insurers.